

**UNIVERSITY OF VAASA  
FACULTY OF BUSINESS STUDIES  
DEPARTMENT OF MARKETING**

Annukka Tirkkonen

**THE IMPACTS OF THE EMERGING MARKETS INSTITUTIONAL ENVIRONMENT ON FOREIGN FIRMS**

A Study on Finnish Cleantech Firms in China

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**UNIVERSITY OF VAASA****Faculty of Business Studies****Author:**

Annukka Tirkkonen

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**Name of the Supervisor:**

Jorma Larimo

**Degree:**

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**ABSTRACT**

The institutional environment affects the strategy that firms must choose in order to do business in a given market and strategy then affects the firm's performance. The purpose of this study was to investigate the changing institutional environment of the emerging market of China and gain an understanding of the different formal and informal institutional factors that have an impact on foreign firms operating there.

This study uses a deductive approach and establishes a framework based on a wide literature review that was tested through semi-structured interviews. The interviews were conducted in Finnish cleantech companies that have extensive history operating in China. The data from the interviews was analyzed together with the theoretical framework to understand the main differences and similarities in them. Cleantech was chosen as the empirical focal point as limited academic research has been conducted in this industry.

According to this study, most of the formal institutional forces in China tend to have more negative impacts on foreign firms. These negative impacts include increased protectionism, weak legal environment and poor information transparency regarding local firms. The informal factors have more positive impacts due to the emphasis on relationships in the market that help firms overcome difficulties created by the malfunctioning formal institutions. The impacts identified are more versatile than depicted in previous studies. The impacts of both formal and informal institutions need to be considered together to evaluate total impact they have on firms. It is important for foreign firms to understand the differences in the institutional environments between home and host country and adapt their strategies accordingly.

It was shown that China clearly needs to pay attention in developing its institutional environment to ensure market growth. Even with all the challenges caused by the transitioning institutional environment, China has become the main market for many foreign firms and despite difficulties firms will continue operating there.

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**KEY WORDS:** Institutional environment, formal and informal institutions, emerging markets of China, foreign firm performance





## 1. INTRODUCTION

This chapter provides an introduction to the study. In this chapter the background of the study will be discussed and after that the research gap, purpose and objectives of this study are presented and finally the definitions of the main concepts will be described along with the structure of the thesis.

### 1.1. Study background

Globalization is causing widespread and rapid economic developments all around the world and has drastically changed the business environment forcing firms and businesses to become increasingly global. The developments in communication and information technologies have shrunk geographical distances and connect together even the furthest parts of the world. Social and cultural changes are transforming our values and bringing consumers closer, making the world one big marketplace. (Cavusgil, Ghauri & Akcal 2013: 1.) These new dynamics of the world economy and global competition have encouraged both large and small firms to expand their business into the emerging economies (Luo 2001: 443). This is due to the saturation and the limited growth opportunities in their Western home markets and to the rapid growth of the emerging markets. The emerging markets, such as the BRICS (Brazil, Russia, India, China and South Africa) and the MIST (Mexico, Indonesia, South Korea and Taiwan), present the futures market arena with constantly growing population and market growth. They have quickly become the center points of the world economy with their quick recovery from the recession and high growth rates of over double the developed markets. (Cavusgil et al. 2013: 1-2; Grant Thornton 2010.)

Over the past few decades' firms have extended rapidly into the emerging markets. This creates new challenges for firm's strategies as foreign firms often lack the knowledge and experience of these new host country markets. Lot of the emerging markets have local restrictions and interventions on ownerships even as they are increasingly releasing these restrictions to attract more foreign investments (Luo 2001: 465.) In the emerging markets, foreign firms are faced with the problems of cultural, institutional and infrastructural differences. It is important for firms to understand the institutional environment of the country they operate in, as institutions affect the strategy that firms must choose in order to do business and strategy then affects firm performance. In Western

countries institutions have long been seen as the background conditions of the business environment and are taken for granted. This creates difficulties when firms are entering into emerging markets where the institutional environment is in turmoil. Many of the emerging markets are in a transition, trying to transform their economies and institutional environment to resemble the Western markets. In the emerging markets the power of the government and social influences are stronger and play a greater role than in developed economies. (Hoskisson, Eden, Lau & Wright 2000: 252- 253.)

Many emerging countries have managed to make tremendous changes in their institutional environment but they still have a long way to go before they reach the level of the developed countries. In the recent years the institutional transition of these emerging markets has suffered severe setbacks such as the Arab Spring, civil wars in Syria, natural catastrophes in Asia and the overall slowing of their growth. These events have again sifted the institutional environment in these markets and created new issues for foreign firms. (IMF 2013.) For these reasons they present both high political and economic risks for foreign firms thus affecting the firm's performance and success in the market. Even as firms encounter many challenges when entering into the emerging markets and especially into China, these countries still interest firms as they are seen as the futures market arena and firms often consider it vital to be active in these markets. Business in the emerging markets has been predicted to continue growing still over double of the developed markets rate unless the future brings big financial or political crises. (IMF 2013.)

In 2011 China consumed over 3.8 billion tons of coal, which is over 80 percent of the worlds coal consumption and the use of coal is predicted to grow still in the future (Walsh 2013). This has caused severe problems in the environment and in the quality of air. Chinas rapid economic development of GDP growth of over 8 percent for the past decade has been the leading causes for this as the country needs more energy to fuel its economic growth (World Bank 2013). China clearly, due to both internal and external pressures has woken up to the situation and China's newest 5-year plan set in 2011 emphasizes sustainability and targets the challenges of pollution and intensive energy use. China's seven priority industries named in the Five-Year Plan include new energy such as wind and solar power, energy conservation and environmental protection and clean energy vehicles. (KPMG 2011.) So there clearly is a new demand for cleantech technology and knowledge in China. This creates an important landscape and demand for the cleantech industry. Combined with the environmental pressure and the need for more energy to help fuel the economic growth China has taken steps to promote the use of

renewable energy and this has created business opportunities for foreign cleantech firms. This change has made cleantech one of the key issues in the trade between Finland and China. The cleantech industry in Finland is a very current subject and one of the key interest areas in the Finnish economy as the target is to create 40,000 new jobs and have a turnover of EUR40 billion by 2018. In 2011 the combined turnover of cleantech companies in Finland was almost 11 per cent of the GDP and 20 percent of Finland's exports. (Työ ja Elinkeinoministeriö 2013.)

## 1.2. Research gap, purpose and objectives

Institutions have been widely studied in many different contexts but the studies mainly focus on one particular aspect of the institutional environment. Often the focus is either on the formal or the informal institutions and only a few studies have attempted to combine these two aspects. It is critical to try and understand the institutional environment as a whole and not just focus on a specific aspect such as corruption or relationships as many previous studies have done. This will help firms to evaluate the environment as a whole and consider the multiple aspects of the institutional environment when entering into an emerging market and operating there. The Cleantech industry provides a unique aspect to the study as the cleantech industry is relatively new and a still rising industry. China's cleantech environment is just starting to formulate and that provides an interesting institutional environment to study. Cleantech will in the future be critical for China to help the country battle the issues in its own environment as well as in the global environment. For this reason it is important to study what the institutional environment is for cleantech companies that operate in China to understand what are the obstacles, challenges and opportunities they face in their operations.

The purpose of this research is to evaluate the importance of institutions in the business environment and gain an understanding of different institutional factors and their impact on firms operating in the environment. This will be done by researching the emerging markets, where the institutional environment has gone through radical changes in the last few decades and focus especially on foreign firms coming from a culturally and institutionally distant country to better understand how the institutional environment is seen. Given the tremendous diversity of institutions this study aims to, through theory and interviews, identify some specific factors in the institutional environment of the emerging markets of China that specifically affect the performance of foreign firms operating in these markets. In order to specify these factors, different factors in both the

formal and in the informal institutional environment are studied through theory and a wide literature review and then a framework will be attempted. This is to shift the focus from the Western countries and their stable institutional environment and focus on the emerging economies that are the next big growth markets in the global market arena and where the institutions are in transition.

Some emerging markets have in the last decade managed to stabilize their institutional environment. But now the emerging markets are becoming turbulent again, due to difficulties in the political environment and also due to their slowing growth rate (IMF 2013) and it is clear that their institutional environment needs reconstructions. It is important to study them to find out how the changes happening in their institutional environment have affected firm performance and what are the changes needed to continue investments into the emerging markets. The focus country for this study is China as it has for years been one of the most promising emerging markets. China has been expected to make extreme changes due to the vast international interest to invest in China but the country is still in the middle of an institutional transition and in need for quick solutions (Position Paper 2013). Finnish firms will be used to help gather empirical evidence to test the theoretical framework. Finnish companies have been investing into the developing countries since the early eighties and the volume of FDI flows has since increased. In 2012 developing countries accounted for 17 percent of the total exports of Finland (Tulli 2013). Furthermore there are many ongoing national projects to help Finnish companies enter into these markets (Finpro – Projects and Programs 2013).

This study continues on the basis of the author's bachelor's thesis and the purpose is to now widen the research with empirical evidence to test the framework created through the literature review. This study aims, through qualitative interviews with Finnish firms to understand the differences and similarities seen in practice and in theory and test how well the theoretical framework is supported by empirical evidence. Through this the study can provide firms with recommendations how to better utilize the differences in the institutional environments and how to enhance firm performance when going into the emerging markets.

The main objective of this research is to analyze how the changing institutional environment of the emerging markets impacts the performance of international firms operating and entering these markets and help firms recognize these institutional factors and plan their actions accordingly.

The objective will be divided into sub-objectives:

- (1) Form a theoretical framework based on prior literature on the emerging market of China, its institutional environment and the formal and informal institutions in this environment that can have an impact on foreign firms and their performance.
  - 1 a) Is the impact positive or negative?
- (2) Through qualitative interviews examine the impacts of the institutional environment on foreign firms experienced by Finnish clean-tech firms operating in China
- (3) Analyze the empirical findings with the theoretical framework to create an understanding of the similarities and differences between the theory and the empirical findings

These objectives will be achieved through a wide literature review into the existing literature and through interviewing Finnish managers with experience of operating in China.

### 1.3. Definitions of key terms

Institutions: often defined as the “rules of the game” and “the humanly devised constraints that structure human interaction.” (North 1990: 3). Institutions are both formal as in laws and regulations and informal meaning norms and attitudes (Peng, Wang & Jiang 2008: 922).

Emerging markets (EMs): growing markets that are being transformed from a premarket stage into the market stage of the Western capitalist economy, These emerging markets have either been centrally planned or heavily agricultural economies that are now rapidly changing due to structural reforms in companies, markets and societies. These markets present a viable opportunity for Western firms and they are rising into the global business arena as the new creators of multinational corporations. (Jansson 2007: 19.)

Performance: can be measured on objective measures meaning firm survival, duration and instability of ownership, subjective measures meaning satisfaction on how the overall objectives have been met as well as on financial indicators such as total profitability and growth. As firms are created for different reasons the definitions of good performance is often dependent on the firm itself. (Geringer & Hebert 1991: 250-252; Hoskisson et al. 2000: 258-259.)

Cleantech: according to Cleantech Finland (2014) cleantech stands for clean + technology and it refers to “technology, services, solutions, process innovation or products that help reduce the environment load caused by human activity, to save energy and natural resources and to improve the living environment.”

#### 1.4. Structure of the thesis

The thesis will be structured as following: first the topic of the thesis is introduced including the purpose and objectives of this research. Then the key concepts related to this research are defined. The theoretical background is divided into three chapters. The first theoretical chapter focuses on the changing role that emerging markets have in today's global market and provides a wider picture of the emerging markets and especially the emerging markets of Asia and China. The discussion also focuses on firms in emerging markets followed by a discussion of Finnish firms in the emerging markets. The second chapter focuses on institutions and the institutional environment of the emerging markets. In the third chapter the institutional impacts on foreign firms and their performance will be drawn on the basis of the previous chapters and the theoretical framework will be drawn.

After the theoretical chapters the methodology of the research is presented. After this the results of the empirical research will be discussed and compared with the theoretical findings. Finally, in the last chapter, the main findings of this research will be summarized and then the conclusions will be discussed in comparison to the objectives presented in the first chapter. This thesis ends with practical implications and future research suggestions together with a discussion of the limitations of this study.

## 2. THE EMERGING MARKETS AND FOREIGN FIRMS IN THE EMERGING MARKETS

In this chapter the definition of the emerging markets will be elaborated and the discussion will focus especially on the emerging markets of Asia and China. The discussion continues with a brief overview of foreign firm operating in the emerging markets and the history and current situation of Finnish firms operating in the emerging markets and China will be briefly discussed.

### 2.1. Definition of the emerging markets

There are multiple definitions of the emerging markets and various different groupings based on different criteria and growth projections. Many different names have been used of the emerging markets such as the Third World countries, developing countries and the newly industrialized countries (NIC) to distinct them from the developed countries of Western Europe and North America. (Cavusgil & Ghauri 1990: 1-2.) Originally the term “emerging markets” was created in 1981 by Antoine van Agtmael, at the time an investment officer at the International Finance Corporation who was trying to start a “Third-World equity fund” to get people investing in developing country shares. His efforts to attract money were rejected until he came up with the term “emerging markets” to suggest progress and dynamism that the term “third-world” lacked. (Economist 2008).

The best know group of emerging markets is the BRICs, created by Jim O’Neill, chief economist of Goldman Sachs in 2001. Brazil, Russia, India and China were then expected to become the next leading economies (Economist 2008). The Acronym has later been redefined to BRICS, now including South Africa. Together these countries make up for over 40 percent of the world’s population, 25 percent of landmass and around 20 percent of the global GDP while controlling around 43 percent of the global foreign exchange reserves (Foreign policy 2012). As the economies around the world have continued to develop, new groupings are needed as new economies have emerged. Often-used groupings are the “Asian Tigers”; fast-growing economies of the South-East Asia (Singapore, Hong Kong, South-Korea and Taiwan), the MIST countries (Mexico, Indonesia, South-Korea and Turkey), the Next Eleven (Bangladesh, Egypt, Indonesia, Iran,



Mexico, Nigeria, Pakistan, the Philippines, Turkey, Korea and Vietnam) and the CIV-ETs (Colombia, Indonesia, Vietnam, Egypt and Turkey) that are predicted to be the next big growth market (Elliot 2011: Roughnee 2011; Reuters 2010). Table 1 shows the emerging markets defined by Gavusgil et al. 2013 grouped by region to give an idea of the countries that are classified as emerging markets.

**Table 1.** Emerging markets by region. (Cavusgil et al. 2013: 4-5).

The Emerging Markets by Region	
Asia	Bangladesh, China, India, Indonesia, Korea, Philippines, Malaysia, Pakistan, Taiwan, Thailand & Vietnam
Europe	Czech Republic, Hungary, Poland, Romania, Russia, Ukraine
Latin America	Argentina, Brazil, Chile, Colombia, Mexico, Peru & Venezuela
Middle East/Africa	Algeria, Egypt, Iran, Morocco, Nigeria, South Africa, Turkey & United Arab Emirates.

Hoskisson et al. (2000: 249) distinguish emerging economies as “low-income, rapid-growth countries using economic liberalization as their primary engine of growth.” Emerging markets include economies from Latin America, the Middle East, Southeast Asia, Africa and the transition economies of formerly socialist countries in East Asia, Central and Eastern Europe and the former Soviet Union (Peng 2003: 277). Luo (2002: 42) gives four basic features that distinguish emerging markets from other markets: (1) relatively rapid economic development, (2) high uncertainty of institutional environments, (3) government policies favoring economic liberalization and (4) structural changes towards a free-market system. Emerging markets are traditionally characterized with a lack of transparency in business operations, uncertain regulation and tax environment, the absence of predictable institutions, institutional instability, underdeveloped consumer demand and weak capital market structure. Problems are also created by the lack of implementation and enforcement even when the necessary laws are in place. Laws can be subjected to frequent changes, which create uncertainties for business. (Estrin & Meyer 2004: 3.)

The emerging economies started to rise as a global market force due to the economic reforms done in the late 1980s, when the emerging markets of Asia and Latin America started to remove their legal obstacles concerning foreign ownership and focusing their monetary policies to better control inflation (Cavusgil et al. 2002: 17). Currently emerging economies account for 80 percent of the world's population and in 2010 their economic growth rates together were almost triple compared to the mature markets (Grant Thornton 2010). For the past decade they have been the major recipients of FDI as foreign firm, especially MNCs wish to take advantages of the business opportunities they propose (Estrin & Meyer 2004: 3). Even with the uncertainties they present the emerging markets are seen as promising market areas due to their huge market size, rapid growth, natural resources and cheap labor force.

## 2.2. Emerging markets of Asia and China

Asia is a large continent stretching from Turkey to Japan and often too complex to be viewed as a one geographic region. For this reason Asia is often divided into South Asia (India, Pakistan, Bangladesh and Sri Lanka), East Asia (China, Hong Kong, the Koreas, Mongolia and Japan), and Southeast Asia (Malaysia, Thailand, Vietnam, Laos, Cambodia, Philippines, Singapore, Indonesia, Brunei and Myanmar) so that firm strategies and actions can be planned more precisely. Most of these countries make up the Asian emerging markets, excluding the developed markets of Japan and the closed markets of North Korea. (Delios & Singh 2005: 44-45.) The attraction of the Asian emerging markets originally lies in the availability of natural resources and low manufacturing wages. The attractiveness has then grown as other factors like rapid economic growth, the size of the domestic market, the quality of human capital, the growth of trade and the existence of adequate infrastructure have emerged. Most Asian countries have introduced new laws on FDI and modified their existing regulations starting from the late 1980s to establish an environment for foreign investment. (Larimo & Mäkelä 1995: 13.)

The Asian emerging market has for long been a specific interest to firms originating from developed countries. Larimo and Mäkelä (1995: 13) noted in their study that at the time, Asia had been the largest recipient of FDI amongst all developing regions. By 1992 its share of the total FDI towards developing countries was 55 percent. In the Asian market, the East Asian countries were of special interest of FDI as they accounted 95 percent of the total flows to Asia. The Asian emerging market has already been tapping at the door of the western markets for the last 30 years. Currently Asia has more

than 3 billion people whereas in the developed countries there are less than a billion people. For the last 10 years the Asian emerging markets have grown at a pace around 4 percent per year compared to the 2,6 percent of the developed countries. (Cavusgil et al. 2002: 161.)

In Asia, emerging economies are all in various stages of transition. The biggest market potential in the Asian market lies in the two BRICS countries; China and India, and in the so called “Asian Tigers”: Singapore, Hong Kong, South Korea and Taiwan (Cavusgil et al. 2002: 161). Growth in the Asian emerging markets has been driven by the decentralization of foreign trade structures, the rising interest and wealth of consumers who have started to demand more differentiated product and the increasing demand for capital-intensive goods associated with FDI. Asian economies have managed to turn their agrarian societies into high-tech centers and amongst all emerging economies they hold the most promise. (Peng 2000: 9, 204.) They are striving to overcome the lack of regulations that has prevented firms from developed countries from entering into the market. One of the most recent evidence of the power of the Asian emerging markets is that they have become the strong force behind pulling the global economy up from the global recession of 2009. (IMF 2009).

China especially has been one of the greatest success stories of Asia. For centuries western countries and firms have been interested in China and today China is a key player in the field of global business and the largest emerging market in the world. The economic liberalization of China began in 1978 and today China has the world’s second largest economy measured on nominal GDP and PPP and is predicted to outpace the US as the world’s largest economy in the next 10-20 years. Prior to the economic liberalization China was a Soviet-style centrally planned economy and has since changed into an investment and export-led economy where many of the old regimes have been dismantled. Chinas economic growth rate has on average been 10,5 percent during the last ten years and foreign firms are interested in its high productivity, low labor costs and relatively good infrastructure compared to some other Asian emerging economies. China is the world’s largest trading power with the total international trade value of USD 3,87 trillion in 2012 and was the world’s second largest recipient of inward FDI of USD120 billion in 2012. (World Factbook 2013; World Bank 2013; UNCTAD 2013.) China is one of the strongest regional powers in Asia and has been thought as the gateway to the Asian markets.

China joined the World Trade Organization (WTO) in 2001 and seemed to be on a path towards opening more to foreign firms. However, the liberalization process of the Chinese market has stalled over the last decade and the inequalities faced by foreign investors have not improved and have in some cases worsened. (Position paper 2013: 24.) China is a very complex country for foreign investors. The administrative jurisdictions have been divided into several areas including 22 provinces, five autonomous regions and several disputed territories such as the Island of Taiwan. China is also a very diverse country ethno-linguistically having over 80 different languages spoken throughout the country. (Understand China 2013.) Furthermore, the economic growth and quick industrialization has not come without a price; Chinas environment is heavily damaged and the economy is highly energy intensive and inefficient. Even as China ranks high on GDP and PPP, the per capita income is still below the world average. Like the other emerging markets, China also suffers from a weak institutional environment and has been widely criticized for piracy and counterfeiting as well as having an undervalued exchange rate.

China faces several economic challenges that it needs to overcome to be able to fully change its economy and compete in the 21<sup>st</sup> century. China is faced with the challenges of reducing corruption, containing the environmental damages such as air pollution and soil erosion related to the rapid transformation of the economy, sustaining job growth for millions of new entrants to the work force and battling low domestic demand as well as a quickly aging population. (World Factbook 2013.) China ranks 29<sup>th</sup> on the Global Competitiveness index out of 184 countries making it the leading BRICS country, but only on 136<sup>th</sup> in the Index of Economic Freedom. The Global Competitiveness report views that China's institutional framework has improved slightly but still battles with the weaknesses in corruption, security, accountability and in ethical standards (Global Competitiveness report 2013-2014; Index of Economic Freedom 2013.) China also faces the challenge of rising production costs and foreign companies are now locating production closer to their market or into the neighboring countries such as Indonesia and Vietnam. Companies are no longer entering into China to manufacture and ship the products back to their home market but to serve the growing domestic market of China. (Kosonen, Kettunen & Heliste 2012: 8-9.)

### 2.3. Foreign firms in the emerging markets

The transitions and opening of these emerging markets has led to foreign firms increased participation in these countries. As the emerging markets grow, the rising income levels have created a new middle class and global firms are now fighting to get a piece of the action. When entering into these markets firms have used varying strategies such as exporting, licensing and contractual agreements and investments. China has been one of the leading receivers of foreign operations as it has been the highest growing economy over the past decades and can currently be considered the world's largest market for multiple products. The growth in these markets has created more wealthy consumers now wishing to obtain more sophisticated and differentiated products. Foreign firms possess a number of advantages over the domestic competitors such as superior quality and heavy marketing budgets. (Peng 2000: 204; Gavusgil et al. 2013: 21.)

Obstacles for firms and investments in the emerging markets often relate to the high investment risks associated with the markets. Risks are associated with the uncertain political and legal environment, a volatile economy with unpredictable changes, the uncertainty of property rights and unclear export market access. These risks vary hugely across the emerging markets and within each market, as there are countries that are relatively low-risk. The second obstacle is the underdeveloped legal infrastructure and bureaucracy. Over time the development has been towards consistency and market orientation of the legal framework but the development is often constrained with bureaucracy and the slow development of the court systems. Problems with bureaucracy arise from inconsistent guidelines for decision makers, the interest of the local administration and in most countries, corruption. Even as the legal framework is developing the issues arise as the administration is not trained to implement the new rules. In many of the emerging markets joint ventures used to be the only feasible mode of entry. This was due to regulations on FDI that required JV-ownership. The regulations have since been relaxed gradually. For this reason the share of JVs used to be high in the emerging markets and especially in manufacturing but since then there has been a massive shift towards fully owned affiliates as both new and old investors have increased their equity shares. (Meyer 1998: 45-47.)

The emerging markets are constantly developing and able to provide new opportunities for foreign firms to venture into. One of the growing trends in the emerging markets is environmental responsibility. Between 2003 and 2009 almost 40 percent of all the low-carbon projects done in the world were directed to the emerging and developing markets

and MNCs were the major undertakers of these projects. (Cavusgil et al. 2013: 104-105.)

### 2.3.1. Finnish firms in the emerging markets

Finnish firms have for decades been actively involved in the global market. This is mainly because of the very limited and saturated home market that is open for foreign firms but also due to highly innovative and technical society. Finnish firms have been very interested in the emerging markets. The Finnish-Chinese trade started to grow heavily in the 1990's specially due to the growth of the IT-industry and during the last two decades China has become one of Finland's biggest trading partners (CEMAT 2013: 39; Kosonen et al. 2012: 8). In 1990 11,5 percent of the Finnish exports went to the emerging markets and in 2012 the figure was 17 percent (Tulli 2013). After the mid 1990's Finnish firms have been increasingly active in investing into China. At first it was mainly large firms in the paper and machinery industry but in the new millennium also multiple Finnish SMEs and service companies have found their way to China. In 2012 China was Finland's fourth largest trading partner with the volume of 7.19 billion Euros and China is one of the top three countries of which Finnish firms are interested in. There are over 300 Finnish firms operating in China of which around half have production in China and the other half sales offices and support units, mainly in the Beijing and Shanghai areas, the Pearl River Delta areas and in Hong Kong. (Team Finland 2013; Kosonen et al. 2012: 8.)

Finnish firms were initially drawn into China as the price of labor was considerably cheaper there and also due to the tax incentives promised by the Chinese government. Today the so-called "China phenomena" is slowing down and many firms are relocating their manufacturing and other operation back to Finland or into China's neighboring countries. This is due to the rising labor costs in China, the rises in oil prices that have then impacted the transportation costs and also due to issues in product quality and safety. Still China continues to be an interest and a huge market for Finnish firms and one of the priority trade partners for Finland due to its huge and growing domestic markets. Now companies are increasingly expanding into the west- and middle regions of China as before companies remained mainly on the East coast. Firms are also increasing their R&D activities in China to better meet the needs of the local markets. (Kosonen et al. 2012: 8-9.)

## 2.4. Summary

Due to the shifting in the global economy and the institutional changes in these markets, competition is now the main feature in these new markets and it is forcing firms to create new strategies in order to succeed in them. Emerging markets have been the driving force behind the changes in how the world does business today and have provided a new market arena for both local and global companies. Firms are increasingly interested in tapping into the huge potential markets that emerging markets offer as well as their lower production costs. Especially the emerging markets of Asia and China in particular have been a major focus of the globalization and growth plans of many foreign firms since they have opened up to foreign trade. Especially Finnish firms with a very limited and saturated home market have a long history of opting for growth in the Chinese market.

The growth in the emerging economies has been remarkable over the past years but in 2013 this growth has started to slow down. IMF (2013) recons that this slowing is only natural after such a long high growth period and it might actually do good for some countries as now they will have time to better take their growth under control. But the continuing reports of slowing growth, volatile currency markets and sociopolitical instability have created gloomy forecasts for the emerging economies and their development. It is still important to remember that the growth in the emerging markets is still four times the growth of the developed economies. But this slowing has made MNC's and other foreign parties cautious about investments. Executives in emerging economies say that structural regulatory and policy reforms are needed together with greater social and political stability and consumer confidence to boost optimism in the emerging economies. (McKinsey & Company 2013.)

### 3. INSTITUTIONS AND THE INSTITUTIONAL ENVIRONMENT OF THE EMERGING MARKETS

This chapter aims to shed light into the various different definitions of institutions. This will be done through a brief discussion into the institutional theory and how institutions affect and function together with firms. The discussion will also look through theory at the institutional environment of the emerging markets and especially the emerging markets of Asia and China.

#### 3.1. The definition of institutions

North (1990: 3) defines institutions as being the “rules of the game” that firms must play by and “the humanly devised constraints that structure human interaction”. Hoffmann (1999: 351) defines them to be “rules, norms and beliefs that describe reality for the organization, explaining what is and what is not, what can be acted upon and what cannot. – in short, asks questions about how social choices are shaped, mediated, and channeled by the institutional environment.” Scott (1995: 33) elaborates these two definitions by defining institutions as “cultural – cognitive, normative and regulative structures and activities that provide stability and meaning to social behavior”.

Institutions are a very wide topic and it often depends on the focus of the study, which aspects are regarded as formal and informal institutions. This study adopts the view that the institutional framework consists of formal and informal institutions that govern individual and firm behavior and are supported by three pillars identified by Scott (1995: 34-45): the cognitive, regulative and normative pillars. These pillars consist of structures and activities that provide stability to social behavior and support the formal (laws, regulations, rules & politics) and informal (norms, culture & ethics) institutions as seen in Figure 1. The regulatory pillar is the supportive pillar for formal institutions. It represents the imperative power of governments as they have the capacity to establish rules, enact and enforce laws and manipulate sanctions meaning rewards or punishments in order to influence firm or individual behavior. These are often more easily identifiable than the informal institutions. The normative and the cognitive pillar support the informal institutions, which in research are often defined as national culture (Zhou & Peng 2010: 355). The normative pillar includes both values (what is preferred) and norms (how things should be done) and tries to explain how the values, norms and beliefs of



others influence the behavior of individuals. It also defines goals and objectives and the appropriate ways to pursue them: the rights and responsibilities and the constraints of social behavior. The cognitive pillar consists of the more internalized, taken-for-granted values and beliefs that guide individual and firm behavior. (Scott 1995: 35-45; Peng 2009: 93-94.)

Degree of formality	Examples	Supportive pillars
Formal institutions	<ul style="list-style-type: none"> <li>• Laws</li> <li>• Regulations</li> <li>• Rules</li> </ul>	Regulatory
Informal institutions	<ul style="list-style-type: none"> <li>• Norms</li> <li>• Cultures</li> <li>• Ethics</li> </ul>	Normative Cognitive

**Figure 1.** Dimensions of institutions (Peng 2009: 93).

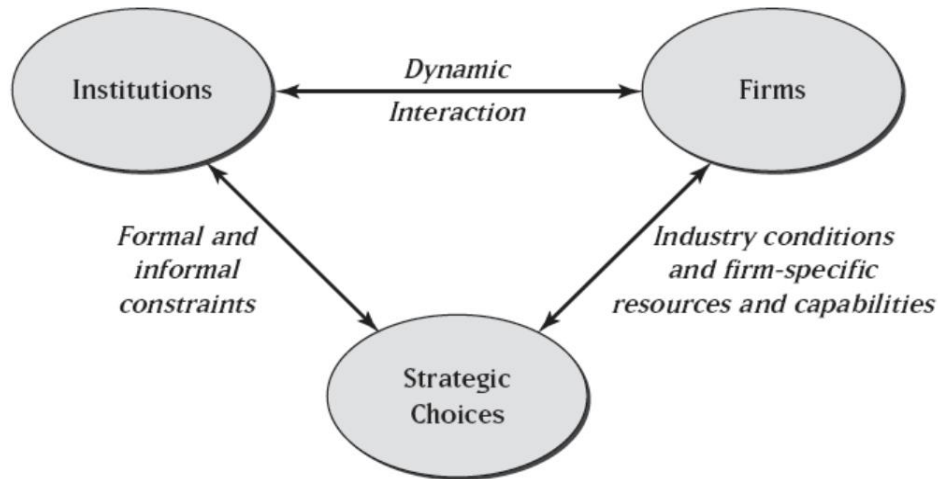
The concept of institutions suggests that economic choices are not only done in the boundaries of technology, information and income but also based on the socially constructed limits that are created by norms, habits and customs (Olivier 1997: 699). The major role of institutions is to reduce uncertainty by establishing a stable structure for human interaction. Even as this is their major role it does not mean that institutions do not change. Institutions are constantly changing and these changes are often complicated as they can affect both the informal and formal institutions simultaneously, meaning that the changes can come in all different forms and the effectiveness of them varies. Also institutions change incrementally. Even as formal rules can change overnight, informal institutions such as customs and traditions cannot as they are deeply embedded with the past, the present and the future. (North 1990: 6.)

Institutional distance is a concept that measures the differences between the institutional environments of the home and host country of a company. It takes into account the differences in both formal and informal institutions. (Arslan 2012: 16; North 1990.) Formal institutional distance refers to the differences in the laws and regulations between the home and host country and informal institutional distance to the differences in the norm, values and beliefs (North 1990). Countries vary in their regulative, normative and cognitive institutions meaning that they vary in their laws and regulations, their norms and customs and in the ways they interpret things. According to the theory of institu-

tional distance, the larger the institutional distance e.g. the distance in the regulation, norms and the way of thinking between the host and home country of a firm, the more difficult it is to establish legitimacy in the host country as well as transfer organizational practices. Therefore, when facing a great institutional distance a firm is faced with issues in both the external and internal environment of a firm. Institutional distance can sometimes be diminished with a local partner or by relying on local personnel in subsidiary operations. Local partners and personnel help to overcome the disadvantages of institutional distance with their knowledge and experience of the local regulative and normative environment that foreign firms coming from institutionally distant countries often lack. (Xu, Pan & Beamish 2004: 286-289.)

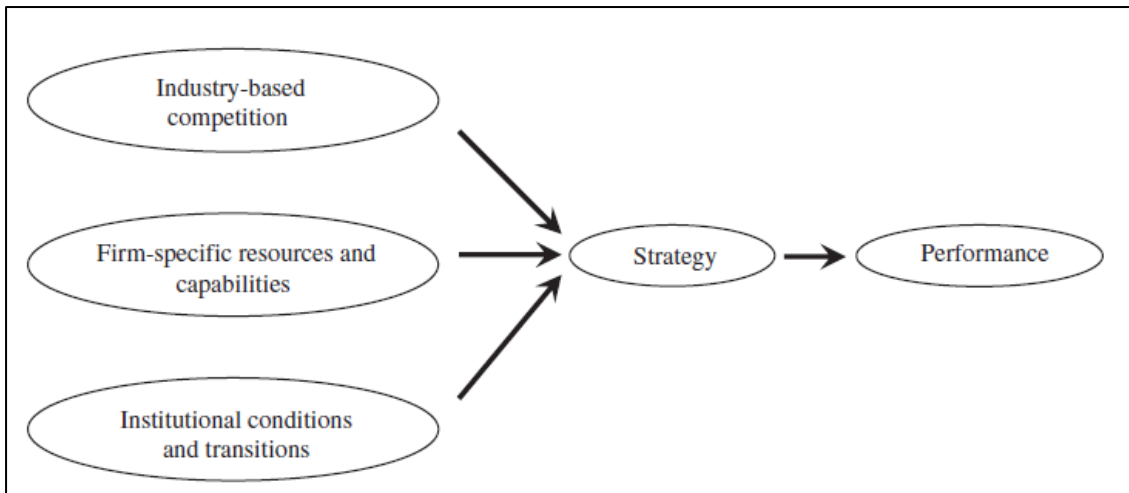
### 3.2. Institutions and firms

Institutions are often researched in comparison with firms to better understand how firms respond to the institutional environment and what type of pressures these institutions place on firm strategy. The main view in theory is that firms need to conform to the rules set by the institutions and the prevailing belief system in order to survive (DiMaggio & Powell 1983). Peng (2000: 45) states that firm strategy is “selected within, and constrained by, institutional frameworks”. Figure 2 depicts this interrelatedness between institutions, firms and their strategic choices. Firms strategic choices and opinions are impacted both by the industry in which they function in and their inner resources as well as by the constraints that the institutional environment forces upon firms. Therefore there is a dynamic interaction and their needs to be an ongoing discussion and evaluation regarding the institutions of the marketplace in which the firm functions in. DiMaggio and Powell (1983) suggested that firms in uncertain environments tend to model each other making them very similar in their strategy and management process. This would mean that no organization has an advantage over the others, as they are all blindly giving in to the institutional requirements of the environment. Organizations need to manage the institutional environment they are in, in order to gain a competitive position. The ability to interpret and to adapt to the institutional pressures is a source of competitive advantage. (Olivier 1997.)



**Figure 2.** Institutions, firms and strategic choices. (Peng 2009: 100).

Firms strategic choices can be looked through the so called “strategy tripod” that is presented in Figure 3. It identifies three ways of looking at the strategic choices of firms. The first is a competition- or industry- based view. According to this view the firms strategy is heavily influenced by the industry it functions in and by the competition in that industry. The second is a resource-based view that suggests that a firm’s strategy formulation is influenced by the firm specific technological, financial and organizational resources and capabilities it possesses. These resources then need to be value adding, unique and difficult for the competitors to attain in order to gain a competitive advantage to the firm. But as the emerging markets have come into the spotlight of the global economy, researcher noted that these two views need to be challenged as firms need to take into account the broader influences such as state and culture, meaning the institutional environment. (Peng 2000: 41-42.) That is why Peng et al. (2008), suggest the use of an institution-based view as firms need to adapt their strategy into the different formal and informal institutions that govern the emerging markets. The institution-based view has two propositions concerning firm behavior. The first is that managers and firms pursue their goals and strategies rationally in the contexts of their own institutional framework. This means that firm actions and performance needs to be looked in context with the institutional environment it is in. The second proposition is that when formal institutions fail, the informal institutions play a larger role in reducing uncertainty. (Peng 2009: 100-102.)



**Figure 3.** The institution-based view: the third leg of the strategy tripod. (Peng 2009: 15).

The key role that institutions have in the business world is to reduce uncertainty that can potentially be devastating such as political uncertainty and economic uncertainty. Uncertainty in a business environment can lead to transaction costs, as in the costs associated with economic transactions. One of such costs is the cost of opportunism meaning deliberate misleading, cheating and confusing the other party in transactions. By helping to determine which actions and conducts are legitimate in a certain institutional environment and which are not, institutions help to define the range of acceptable actions for individuals and firms. Institutions also help to spell out the common rules of the game so that violations can be punished. Without institutions the transaction costs could possibly rise so high that transactions would stop. (Peng 2009: 94.) It is important to know that institutions can also have a negative effect on firms. Firms can within themselves become “institutionalized” meaning that they are stuck in certain types of activities as it is the way things are always done. These routines can limit firms from seeing the best alternatives and make inappropriate decisions based on their gut feeling instead of economic data. (Olivier 1997: 700.)

### 3.3. The institutional environment of the Asian emerging markets and China

The most prominent feature of the institutional environment of the emerging markets is that they are in constant transition. Institutional transition can be described as “fundamental and comprehensive changes introduce to the formal and informal rules of the

game that affect organizations as players” (Peng 2003: 275). It has been said that the “only constant in emerging economies in Asia is change” (Peng & Zhou 2005: 321). In China, the change from a centrally planned economy into a market-based economy has been so pervasive that China is sometimes referred as a transition economy. Still this change has not happened overnight, but gradually over the past 30 years and it is still in process. China is now on the verge of new institutional transitions to truly transform to a completely market orientated economy. This creates fundamental changes on both the formal and informal rules, which of course then impacts the players of the game meaning the firms that do business in these markets. (Zhou & Peng 2010: 358; Peng 2003: 275.) As the institutions are in constant transition it means that the institutions are often unable to fully ensure the effective functioning of markets.

Asian countries are often described as being institutionally underdeveloped or institutionally weak countries. Many of them suffer from underdeveloped financial markets, poor corporate governance, unproductive and poorly trained workforce, inefficient and corrupt governments, inefficient juridical systems and weak law enforcement. All of these limit the opportunities and actions that foreign firms can take in the market. (Delios & Singh 2005: 56.) In recent years the Asian emerging countries have started to pay attention to the weaknesses in their institutional environment in order to develop especially their formal institutions. Governmental policies have changed significantly as in most countries the entire regulatory system has undergone a transformation. Many countries in the region have managed to completely transform their formal and informal institutions to resemble the institutional environment of the developed countries. Existing institutions are giving room for new institutions as formal rules are changing to provide firms with more protection and less restrictions. (Hoskisson et al. 2000: 252-255.) This is to open up the markets in order to attract more foreign investment to help with the development and building of necessary infrastructure and to compete in the global market. Still many of these structural transformations have led to unexpected changes in governmental policies resulting in making the policies nontransparent (Luo 2002: 41). The changes happening in the institutional environment are constant and often not long-standing as formal regimes can easily change overnight (Hoskisson et al. 2000: 255). The institutional environment has been very turbulent and often characterized as uncertain as fundamental institutional changes have been known to happen overnight. Even in cases where the development of institutions has been slower they have been characterized with uncertainty as governments are quick to break down the old institutions but then lack in the construction of new institutions to take their place. (Peng 2003: 278.)

There are vast differences in the institutional environment of the emerging markets compared to the western markets. In developed countries, the institutions are characterized with strong legal regimes, binding social norms and effective sanction system. Solid legal foundations provide firms with guaranteed property rights, predictable tax laws, nondiscriminatory incentives, transparent labor laws and clear anti-monopoly regulations. The institutional environment is more stable and more transparent thus providing a stronger protection for firms and their operations than compared to emerging markets where institutions are often defined as the opposite. In the developed countries, institutions are often defined to be “invisible” in a sense that they are taken for granted. This is why firms from developed countries may confront difficulties when entering into the emerging markets as they lack the understanding of different institutional forces. (Meyer, Estrin, Bhaumik & Peng 2008: 63-64; Luo 2002: 40; Jansson, Johansson & Ramström 2007.)

The informal institutions also differ greatly. Especially in the Asian market, the cultural differences can create difficulties for Western companies. The culture in Western countries is often defined as individualistic; meaning that they are less committed to group harmony and norms, and more focused on the individual and individual performance. Also business relationships are less socially strong and they are built on rational decisions. In the Asian countries the culture is collectivistic meaning that the group you belong to is very important and peace is often sought after within the group. Business relationships are socially strong and business is guided by intuition and feeling. Western companies often face problems when encountering a collective culture as most decisions there are done as a group and not by individual managers. (Hofstede, Hofstede & Minkov 2010: 90-134; Jansson et al. 2007: 959-960.) It is common in the Asian market that informal relationships play a more vital role in business as they are often needed to substitute the weak formal institutions. Therefore success in the Asian market can be based on the people you know where as in Western countries success is based on the efforts of the individual. (Jansson et al. 2007: 959.)

China ranked on place 123 out of 152 on the Economic Freedom of the World report and on place 136 out of 177 countries on the Index of Economic Freedom putting it in the “mostly unfree” section on both rankings. This can be seen as an indication that the country is still struggling in the reformation of its institutional environment. In both reports, a higher country score represents the openness of the economy to international business, the presence of strong market institutions, ease of business for foreign firms and good financial and fiscal policies. China ranks on the least free section so there are

still multiple obstacles for foreign firms in the country and the institutional environment is still in transition. Even as China has managed to gradually improve the state of the country's economic freedom, it still falls greatly behind from both the global and regional averages. (Economic Freedom of the World 2013; Index of Economic Freedom 2013.)

### 3.4. Summary

The key function of institutions is to reduce uncertainty both for individuals and firms. This is done by defining the acceptable behavior and actions that can be taken. The reduction of uncertainty is very important as in the business environment it can lead to transaction costs meaning the costs created by negotiating and formulating transactions. Without institutions, transaction cost can become so high that transactions can cease to take place. Institutions also have the role of reducing information cost by helping to establish stable structures that facilitate interaction and the gathering of information. The lack of an institutional framework to protect investments in the host country can lead to investors ceasing to invest. (Peng 2009: 94-96.)

Institutions are critical in understanding the external and internal forces that affect the strategy and choices of foreign firms. It is no longer a question if institutions matter but a question of how they matter, to what extent and in which ways and in what kind of circumstances (Peng 2003: 276). They are especially important in understanding the emerging markets and their business environment as government and social influences are stronger there and play a greater role than in developed economies (Hoskisson et al. 2000: 252). The host countries institutional environment strongly affects the way foreign firms behave and enter those markets and often determines the attraction of a specific foreign location (Peng 2003). Institutions have long been seen as the background conditions of the business environment and have been taken for granted. The rise of the emerging markets into an important role in the global economy has forced firms to start paying attention to those silent forces effecting firm performance in emerging markets, where the absence of strong institutions has been evident. (Peng et al. 2008: 922.)

## 4. THE IMPACTS OF INSTITUTIONS

In this chapter the impacts of the institutions in the emerging market on foreign firm performance will be discussed. The discussion will focus on the formal and informal institutions impacting firm performance. How can these institutions improve performance and what are the limitations and constraints they present.

Strategy affects firm performance and institutions affect the strategy that firms must choose in order to do business in the emerging economies. The host country institutional environment sets the guidelines, which influence the structures, strategies and activities of firms and business. Especially in the emerging markets institutions are often seen as forces that limit firm actions and force constraints on firm strategies as well as adding costs to their actions. Institutions have also the ability to create opportunities: the changes happening in the emerging markets institutional environment have led to the opening of those markets and their growing stability that makes it easier for foreign firms to function in them and do business.

### 4.1. Formal institutions and their impact on foreign firm performance

Formal institutions, often referred as the regulatory institutions, focus on the formal rule systems in a society (laws and regulations) and the enforcement mechanisms sanctioned by the state (North 1990: 46 & Peng 2003: 276). Formal institutions affect the flow of business and the smoothness of business transactions through regulations and the actions of regulative officials when they implement these regulations (Kosonen 2011). In the emerging market it has often been viewed that even though the development of the markets has been rapid, the development of institutions has not been as fast. Studies have found that especially the formal institutions that provide the basis for effective business operations, have been slow to develop and are often described as being weak. The lack of a strong legal framework increases opportunism, bribery and corruption. Emerging markets often lack political and economic stability and key institutional features such as infrastructure, skilled labor and capital markets. They also often lack the ability to enforce the laws and regulations even if they are there. There are also information problems as market information can be hard to access. (Hoskisson et al. 2000: 252; Zhou & Peng 2010.)



Zhou & Peng (2010: 358-361) use competition institutions, legal institutions and information institutions to distinguish formal institutions. Competition institutions refer to the institutions governing market competition, open trade and business entry and exit. These institutions affect the number of players on the market and this then has an effect on the business networks and transaction cost. Today many countries are under growing international pressures to promote fair competition. Legal institutions refer to the efficiency of the juridical system. Weak legal systems are often the cause of high transaction costs as the players cannot trust on the laws to guard their transactions. This creates a situation where firms are more forced to rely on their personal networks. The main issue in emerging markets and especially China is that even as the laws are in place, the enforcement is not. Information institutions are “laws, regulation and organizations that define corporate and product information disclosures and certifications”. Weak information institutions increase information asymmetries where as working institutions help reduce the uncertainty in the market. Emerging markets are often characterized with weak information institutions.

Delios & Singh (2005: 55-66) classify formal institutions in an Asian context into political institutions and legal institutions. Political institutions are related to the level of government control over resources, the level of government intervention and to the level of uncertainty in the regulatory environment. The level of controlled resources directly affects a firm's resource dependency on a government. In some countries governments have a monopoly control over scarce resources like land, raw material, capital, licensing as a business entry, subsidiaries and tax arrears. This dependency forces firms to build strong ties with government officials. Furthermore, this type of dependency often leads to corruption and bribery.

This study will follow with the classifications given above and the formal institutional environment of China will be viewed through three groups: political, legal and information institutions. The political institutions will include political institutions mentioned by Delios and Singh (2005) and the competition institutions used by Zhou & Peng (2010). This group will include the trade barriers that foreign firms face in the market, government restriction on foreign firms including laws and regulations and the incentives used to promote foreign business as well as issues in intellectual property rights. The second group is the legal institutions suggested by Zhou & Peng (2010) and this focuses on the issues caused by weak legal institutions, the issues of effectiveness of systems and implementation as well as the constant changes in the legal systems. The third group is the information institution (Zhou & Peng 2010) that focuses on how in-

formation is governed and published in China and the amount of transparency and regulations governing information institutions.

#### 4.1.1. Political and competition institutions

Formal institutions have been seen to influence foreign firm performance and strategy more than informal institutions. Through political and competition institutions the host country government can influence and limit the strategic options the firms have, create dependency to the government by controlling scarce resources and control the competition in the market. Especially the regulatory demands and restrictions set by host country governments have a major influence on foreign firm performance. As the emerging markets often lack market-supporting institutions, the governments are more active in regulating industry development, influencing corporate operations and guiding business policies (Hoskisson et. al 2000). Laws and regulations can both help foreign firms as they provide stability and reduce uncertainty, but they can also cause harm, as host country officials can use them to directly restrict foreign firm behavior or try to influence it through incentives and guidance (Arslan 2012: 112).

There are various ways in which the host country can seek to influence foreign firm behavior and operation and they vary by industry, location and implementation. Through formal institutions host countries mainly aim to influence either the ownership or the performance of firms. In Asia, governments typically have a tendency to intervene more heavily in business than in the developed countries and the government influence to the market is relatively high in China (Delios & Singh 2005: 60). Governments usually have a strong incentive to behave opportunistically and use their legal and regulative power to influence firm behavior either through restriction or through incentives and guidance. Especially in the emerging markets governments often directly aim to impact the entry mode decision of foreign firms by imposing ownership restrictions or financial constraints on certain entry modes. Deviations from these rules can result in financial penalties. During its economic transition and reform, the Chinese government has retained a central role in the process. (Luo 2005.) Ownership restrictions are very common in the Asian emerging economies according to the study done by Chen, Paik & Park (2010: 528-530) on IJVs in China. By promoting and restricting investments in certain sectors governments aim to steer foreign investors into the direction they prefer. The treatment in the market is different towards different types of firms. The preference of a certain entry mode is often visible in the taxation and in the industry access. (Luo 2005: 213.) Ownership restrictions are used to guarantee local partner and government

involvement. Often foreign firms are required to form IJVs with state owned enterprises as it gives the host country government's direct control in the venture. Foreign firms are also forced to operate with government owned companies as the majority of China's largest business groups are controlled by the government. This affects the strategic options of the firm and can alter performance as the government involvement places restrictions on the actions firms can take. Governments might resort to taxation, foreign employment restrictions, selective bureaucratic delays and foreign exchange restrictions to achieve their goals. Foreign firms often settle for forming IJVs in order to keep good relations with the host country governments. (Julian 2005: 29-30; Chen et al. 2010: 529; Cavusgil et al. 2013: 72-73.) As the deregulation of the markets continues, other modes of operations emerge and so do the regulations. In 2011 China informed that it will implement a new security control on foreign acquisitions. This forces foreign firms to inform the Chinese ministry of commerce when they are about to purchase a controlling position in a Chinese firm. If the ministry feels that the acquisition affects the national security, the trade can be denied. (Kosonen 2011: 30.)

Government incentives are used as the main instrument to attract foreign investments, especially in the emerging economies where economic development is often the government's main priority. These incentives, such as fiscal and financing, can have a major impact on a firm's profitability but they are often tied to performance requirements meaning that when the firm meets the given requirement it can gain e.g. tax benefits that can then help to improve the financial performance. (Delios & Singh 2005: 62, Chen et al. 2010: 528-530.) The Chinese government has many incentives to help attract foreign investment such as tax incentives in R&D, customs duty and VAT exemptions, tax free revenue from certain transfers e.g. technology and with special economic zones. The incentives are greatest in governmentally encouraged sectors and industries such as high-tech and infrastructure and in the special economic zones. Also firms located in the open coastal cities often enjoy lower income tax rates than in other parts of China. These tax incentives often require the company to have a residency in China and for them to practice the given business activities there in order to gain the incentives. Firms that for joint ventures with state-owned partners often benefit from closer connections with the government and are rewarded with lower regulatory and institutional interference. (KPMG 2012; Luo 2005: 214.) China has several "special economic zones" that were originally established to encourage foreign investment into the country. These special economic zones provide many benefits for companies such as tax exemptions starting from two years up, lower tax rates, customs exemptions, simpler entry and exit rules and easier access to the rest of the Chinese market. (Cavusgil et al. 2002: 171.) In

the recent years the Chinese government has been especially promoting non-fossil energy development such as wind power, nuclear power and hydropower as a part of their low-carbon development strategy (IEA 2011: 53).

Overall doing business in China is not always easy. On the Ease of Doing Business index China ranks 96<sup>th</sup> out of 189 in 2013 (Table 2). This means that even as there have been several improvements made in the past recent years there are still many obstacles in doing business in China. And when looking in comparison to the year 2008, before the financial crisis, it is obvious that overall China's position has gone down on the list. In China, business is heavily regulated meaning that starting a business and running it requires multiple permits and the process of getting these permits is very bureaucratic. As it can be very time and money consuming to get these permits, corruption is often visible in these situations as government official offer to speed the processes for unofficial payments. (Doing Business 2013; Kosonen 2011: 1.) China has made vast improvements in the regulative environment and has since 2001 removed or lowered the requirements on over 2400 government requirements set on foreign investments and production as well as removing numerous time consuming government approval policies. Still the requirements and the political interference on foreign investments are heavy and needs to be reduced even more. (CEMAT 2013: 35.) Many foreign firms have felt that China's political environment has become more restricting and more discriminatory towards foreign firms. Protectionism has grown in the Chinese market and has affected especially ownership restrictions and standards. This can be seen as a result of the tightening of regulations concerning foreign firms that was done after the financial crisis and also from the political targets to stimulate domestic companies. (Kosonen 2011: 27-28.)

Especially the central government in China can be highly bureaucratic due to multiple ministers holding overlapping responsibilities in regulatory functions thus affecting enforcement (Position Paper 2013: 5). The high and inefficient government bureaucracy is one of the most problematic factors for doing business in China according to the Global Competitiveness Report with a score of 10,2 percent of the answers (2013). Furthermore there is often a lack of understanding between the roles of different governmental offices. This overlap causes duplicated and contradictory regulations that burden foreign firms affecting their efficiency and creates risk of unfair and inconsistent enforcement. (Position Paper 2013: 5.)

**Table 2.** Comparison of the ease of doing business in China in 2008 and 2013. In the comparison of 178 countries in 2008 and 189 in 2013. (Doing Business 2008, 2013).

<b>Business sector</b>	<b>2008</b>	<b>2013</b>
Starting a business	135	158
Registering property	29	48
Getting credit	84	73
Protecting investors	83	98
Paying taxes	168	120
Trading across borders	42	74
Enforcing contracts	20	19
Resolving insolvency	57	78
<b>Overall ranking</b>	<b>83</b>	<b>96</b>

Bureaucracy against foreign firms in China has increased in the recent years. This is especially targeted on the investments as well as imports and exports and could indicate that the policies towards foreign investments might be tightening in China. It is clearly harder to start a new business and end a business in China and the investment protection is weaker due to increasing complexity in the regulative environment. (Kosonen 2011: 27).

Market access has been one of the main issues for European businesses wishing to operate in China. They have estimated that in 2012 European companies missed out on 15,5 billion Euros worth of potential revenue due to market access restrictions. There are sectors such as logistics that are completely protected and restricted from foreign firms. There are many things restricting foreign firm operations in China and affecting competition. One of these things is trade barriers that exist in the market. The biggest trade barriers reported by Finnish companies associated with China are presented in Table 3. The top issue reported by Finnish firms is the problems related to IPR especially in three areas: trademarks and related problems, copying and piracy and the slowness of the work of the authorities. The legislation on intellectual property rights has developed in China but again the main issue is the lack of enforcement and the monitoring of the laws. The second biggest trade barrier was reported to be the increased levels of custom tariffs. When China entered into the WTO, the custom tariffs levels dropped on many products but the problems arise with new product for which China is not bound to maximum tariff levels. Another problem has been the discriminatory and unfair product

specification as well as certification requirements and inspections that seem to favor domestic firms. The practices change rapidly so it is hard for companies to keep up with the changing requirements. Other issues were high tax withheld at source, customs procedures, market protection measures, collection of the value added tax and the participation of foreign enterprises in competitive bidding for public procurement. (Team Finland 2013.) In 2005 the main issues with China were “high customs tariffs, unclear, slow and unpredictable customs procedures, infringements of intellectual property rights, and technical barriers to trade.” Finnish firms reported that customs procedures were complex and varied a lot and involved high costs.

**Table 3.** Trade barriers in China by type, adapted from Team Finland (2013).

#	Type of Barrier	% of answers
1	Intellectual property rights	20,3
2	Customs tariffs levels	15,3
3	Discriminatory product specifications	10,2
4	Other barrier	7,6
5	Movement of capital	7,6
6	Customs procedures	7,6
7	Tax problems	6,8
8	Movement of persons	5,9
9	Anti-dumping and countervailing duties and safeguard measures	5,1
10	Legal status of the enterprise	4,2
11	Public procurement	2,5
12	Quantitative restrictions and licensing	2,5
13	Business environment	2,5
14	Competition conditions	1,7

In regards of IPR the main issue was seen with the lack of implementation and supervision and the local administrations tendency to favor Chinese companies. Technical barriers were certification requirements and the lack of well defined standards and approval specifications. The 2005 trade barrier report found that one of the main problems in China was the defects in legislation and the implementation of the legislation and also corruption in the public sector. (Ministry of Foreign Affairs 2005.) So it is clear that the

trade barriers found by Finnish firms in China have stayed relatively the same since the first report published in 2005. When comparing the comments made in 2005 and 2013, it seems that IPR has become the biggest issues for Finnish firms operating with China where as in 2005 the main problems were with customs. It is interesting to note that even as the development of the Chinese market has been rapid over the 8 years between the two reports the same issues still exist and clearly show that the formal institutional environment of China has not developed as quickly as one could assume. The legislative environment still often lacks enforcement and implementation and corruption is still reported to be a big issue in the market.

China has for long had a very negative reputation when it comes to intellectual property rights, copying, piracy, forged products and patent violations. The main reason for this type of behavior is the traditional Chinese understanding, that learning happens through mimicking the master's work and by copying you show that the work is very highly regarded. This clashes strongly with the Western ideals that inventions should not be copied but respected as they are and only copied if proper authorization and payment are given. Sometimes it is viewed that the Chinese understand the word copyright as the right to copy. In 2007 it was evaluated that 70 percent of the world's pirate products originate from China and that the pirate industry generates over 500 billion dollars annually. (Kosonen 2011: 37-38.) In 2013 China ranked 57<sup>th</sup> out of 130 countries on the Intellectual Property Right Index (2013). So overall the IPR environment seems to be doing relatively well but the IPR index reported only a 0,5 percent increase since 2009 and for the last four year the score has remained the same. The development of the IPR environment has been stagnant and shows no signs of significantly improving if it continues on the same path as until now and overall Chinas ranks low regionally. On the protection of IPR and patents China ranked relatively well on place 33 but on copyright protection China was on place 79. Appendix 1 shows Chinas overall ranking on the IPR index and it is evident that Chinas biggest issues are in intellectual property rights and in their legal and political environment, which the IPR index also measures. So China clearly has issues with IPR protection.

In the survey done by Team Finland on the barriers of trade for Finnish firms the respondents felt that the greatest share of IPR problems occur in China. Especially problematic where in trademarks, copying and piracy and in the slowness of the local authority. This problem of course varies greatly among firms and industries and depends on the product, the level of technology, the competition in the given industry as well as on the operation mode of the firm. (Team Finland 2013.) Firms are often not willing to

bring their best technologies into China even though the Chinese government is providing tax incentives especially concerning R&D. Foreign firms are often worried about losing their technological know-how and trade secrets due to forced technology transfer that in China is often used as a precondition for market access for example some license procedures can require firms to disclose information beyond the most international practices. (Position paper 2013.) The process of protecting your IPR in China is very time consuming as trademark registration can take up to 36 months. Even as the legislations concerning IPR has developed tremendously over the past few years, the enforcement and monitoring of the laws is lacking and courts often disregard the laws and favor the Chinese parties. Therefore neither firms nor consumers respect the laws. Firms feel that their possibilities to protect themselves against copying and defend their patents in courts are poor because the local authorities often tend to favor the local Chinese parties. Even when sanctions are imposed they are not followed through or they are often very minor compared to the violations. Another problem is the slowness of the patent and IPR handlings and often very costly, so in many cases companies are relying on just negotiating by themselves with the offenders and hope they will not do it again, which rarely happens. So it can be a constant battle against different violations towards your products on a daily basis. (Team Finland 2013; Kosonen 2011: 38-40.) When firms take their technologies to China they are faced with costly protection procedures against patent violations and constantly monitoring the market for copied products as even though their technologies are protected by law.

#### 4.1.2. Legal institutions

The regulatory environment of China has now for years been very active and constantly changing to better adapt to the global business environment and to the rapid changes happening in the economy. Especially after joining the World Trade Organization (WTO) the regulatory environment of China has become more predictable and also many new laws to help foreign investment have been made. Still China's regulatory and legislative environment has developed very cautiously when compared to other emerging economies. There are many emerging economies in which the regulative environment is much more advanced than in China. Where as many emerging economies introduces competition laws in the 1990s, it took China until 2007-2008 when the antimonopoly laws were introduced (Zhou & Peng 2010: 359).

Even as the legislation governing international business in China appears to be similar with the Western legislation, it is in many cases said to be vague thus leaving a lot of



room for interpretation. In many cases regulations are left without specific definitions of the matter as well as the necessary actions that need to be taken and the time frame for everything. This leaves firms alone with the regulations wondering when to take actions and what kind of actions and subjects them to the arbitrariness of the government officials when the regulations are implemented. The main problem in the regulatory environment is the constantly changing legal framework. The legal environment in the Asian emerging economies is often very influential but also complex and not easily predictable. (Peng & Luo 2000: 488; Kosonen 2011: 30.) Sometimes the changes in regulations happen so quickly that even the government officials cannot keep up with the change. This can put companies in a difficult position as they do not know the policy changes and the officials cannot help them as they themselves can be unaware of the changes. Regulations have also been known to change retroactively. (Kosonen 2011: 28.) As the regulatory framework is still developing, firms are often left without proper protection from various forms of misbehavior such as opportunism, piracy, false advertising, contract violations and corruption. An incomplete legal environment can provide a stronger incentive to cheat so firms can find it very difficult and expensive to protect themselves, as they have no formal authority to enforce punishment. (Sheng, Zhou & Li 2011: 3; Luo 2005: 214.)

The Chinese court of law often functions on the basis of the local government, as that is the place for their financial resources. This makes the local courts and judges open to corruption as well as questions their independence. Even as all of the power is on the Communist party and the course of conduct comes from Beijing, there are no guarantees that the local courts will follow that. This variation in what rules everyone then follows in different local governments is also visible in the standardization process for certificates needed in the market. Especially for high-tech firms, market entry often requires them to submit to pricy and complicated testing procedures over and over again as there are no nationwide specifications for the process and the requirements can change rapidly. (Kosonen 2011: 31-32.) In the absence of a strong legal framework firms need to rely more on contractual solutions to protect themselves and their investments to the relationship (Luo 2005: 214). The lack of legal frameworks puts constraints on partner selection and monitoring. Time and other resources need to be taken away from other activities to control the possible misbehaviors thus creating extra expenses that can then affect the performance of a firm.

The constantly changing formal institutions also force constant structural changes on industries as the regulations regarding them change. Industry structure can be highly

uncertain due to the experimental nature of multiple new industrial policies. There can be a lack of sufficient information concerning the industry structure and its changes. Government regulations differ among industries, as do the industrial policies concerning privatization, which causes huge varieties in sales and profitability amongst industries. The institutional changes effecting industry level regulations often lead to difficulties obtaining and verifying information which in turn limits decision-making alternatives for firms. Especially, the governmental industrial policies can be vague and lack enforcement. Industry uncertainty can lead to increased uncertainty in property rights, building permits, fair competition and returns. Instability in the industry is also caused by the various degrees of decentralization and privatization in the emerging markets. As government policies, incentives and regulations often vary across industries they impact organizations differently. (Luo 2003: 1318; Luo 2007: 42-43.) Cleantech as an industry is very heavily regulated to begin with so it requires a lot of certificates and only a few firms are able to enter the particular sector. There are also often the country specific restrictions. The Chinese government has been very supportive towards cleantech. The government uses state-owned enterprises as tools for its cleantech policies. (Karjula 2013: 49-50.)

#### 4.1.3. Information institutions

Zhou & Peng (2010) argue that economic growth in emerging markets is often negatively affected by malfunctioning information institutions. Information institutions are the laws and regulations that define corporate information disclosures. Weak information institutions lead to poor accounting transparency, lack of financial disclosure and weak institutions to verify the quality of information available in the market. China has often been accused of being legally and politically very non-transparent. According to the Global competitiveness report 2013-2014 China ranks 80<sup>th</sup> out of 148 in the “Strength of auditing and reporting standards” where a smaller number indicates that the standards are strong in a country. China’s score indicates that the standards on how firms are audited and how this is then reported are relatively poor. This means that the available information regarding Chinese firms and their financial state can be very poor in quality or even non-existent. Finnish firms have noted the difficulty of gaining trustworthy and accurate information on potential partners and the market creates obstacles in operating in China. This often limits the amount of potential business partners that firms can choose as it is difficult to spot out the cheaters without proper information in the market. It also forces the firms to spend a lot of time and money to try and find out the truth about their potential partners. This then limits the available transactions to the bounda-

ries of trustworthy network members. (Global Competitiveness Report 2013-2014; Kosonen 2011: 28, 31; Zhou & Peng 2010: 360-361.)

These information asymmetries increase partner-related risks, as firms are not able to access information concerning the partner. Firms are also forced to spend more resources in searching and analyzing the information needed. Often the information in the emerging markets can be uncodified, which creates greater difficulties for gathering and understanding it. (Meyer et al. 2009: 63-65; Luo, Tan & O'Connor 2001: 12.) Especially when wishing to formulate a partnership with a Chinese partner, information institutions become highly important. As there might not be enough quality information available in the market concerning possible partners, foreign firms can end up forming partnerships with unsuitable partners. As the accounting and credit information might not be transparent, the financial state of the partner might be hard to verify fully beforehand. When entering into new markets, foreign firms might have only a limited amount of partner options and it can be hard to select the most suitable one. Information markets in China are not yet fully developed. For this reason information is passed through networks rather than formal channels. (Luo 2003: 1317.) This means that firms need to find the right networks in order to get better quality information. Table 4 summarizes the different factors that affect foreign firms operating in China found above.

**Table 4.** Factors of the formal institutions affecting foreign firm performance in the emerging economy of China.

**Factors negatively affecting foreign firm performance:**

- Government restrictions on e.g. ownership
- Trade barriers
- Heavily regulated environment and high bureaucracy
- Lack of IPR protection and slowness of law enforcement on IPR matters
- Constantly changing and developing regulatory framework
- Inefficient enforcement of the law
- Information asymmetry

**Factors positively affecting foreign firm performance:**

- Government incentives, tax reliefs & resources
- Developing legal framework working to establish laws to help provide stability

#### 4.2. Informal institutions and their impact on foreign firm performance

In addition to formal institutions, informal institutions have a vital impact on foreign firms' performance. Many studies often focus on the formal institutions and tend to understate the importance and the role of informal institutions. It is important to note that formal and informal institutions interact together and informal institutions can improve or undermine formal institutions and are especially significant in the emerging economies where formal institutions are not well-functioning, non-transparent and unenforced. (Estrin & Prevezer 2011: 42.) According to the institutional theory, institutions support the effective functioning of market mechanisms and when formal institutions fail, informal institutions take their place as substitutes to facilitate economic activities. Especially in the Asian emerging economies, the informal institutions are the key form of governance during the institutional transition, as the market supporting formal institutions are insufficient. (Peng 2003: 278.) Informal institutions can be understood as national culture, which then defines the norms, values and the level of trust towards foreign firms in a certain society. Culture is also behind the behavioral expectations or beliefs concerning legitimacy of certain operations and relationships. (Zhou & Peng 2010: 362.) Informal institutions often influence the economic behavior of firms (Peng et al. 2008). The biggest limitation and threat informal institutions place on foreign firm performance, in comparison to the formal institutions, is that they are often not visible to outsiders and that makes it difficult for firms to adapt to them (Xu et al. 2004). The impacts of the informal institutions arises from the norms and values of the society and a firms strategic behavior can be affected through the constant interaction with the social and cultural environment of the host country (Peng et al. 2008).

Informal institutions have two roles in the literature. Informal institutions are regarded as being the problem solver as they can help and assist social interaction and help coordinate and improve the efficiency of complex formal institutions. Informal institutions are also sometimes regarded in a more negative role as through tight relationships used to bypass the formal institutions often comes corruption or clan politics that undermine the market. (Estrin & Prevezer 2011: 44.) For foreign firms, informal institutions can impact many aspects of operating in the host country such as understanding the partners and their goals, the management of a subsidiary and managing conflicts and the level of adaptation to the local environment (Arslan 2012: 62).

Corruption and national culture (adapted from Arslan & Larimo 2012 and Zhou & Peng 2010: 362) are used as categories of informal institutions in this study as they address

the key aspects of the informal institutional environment. In this study, the relational emphasis and importance of networks in the Chinese market, also often referred as “guanxi” will be included as a separate category.

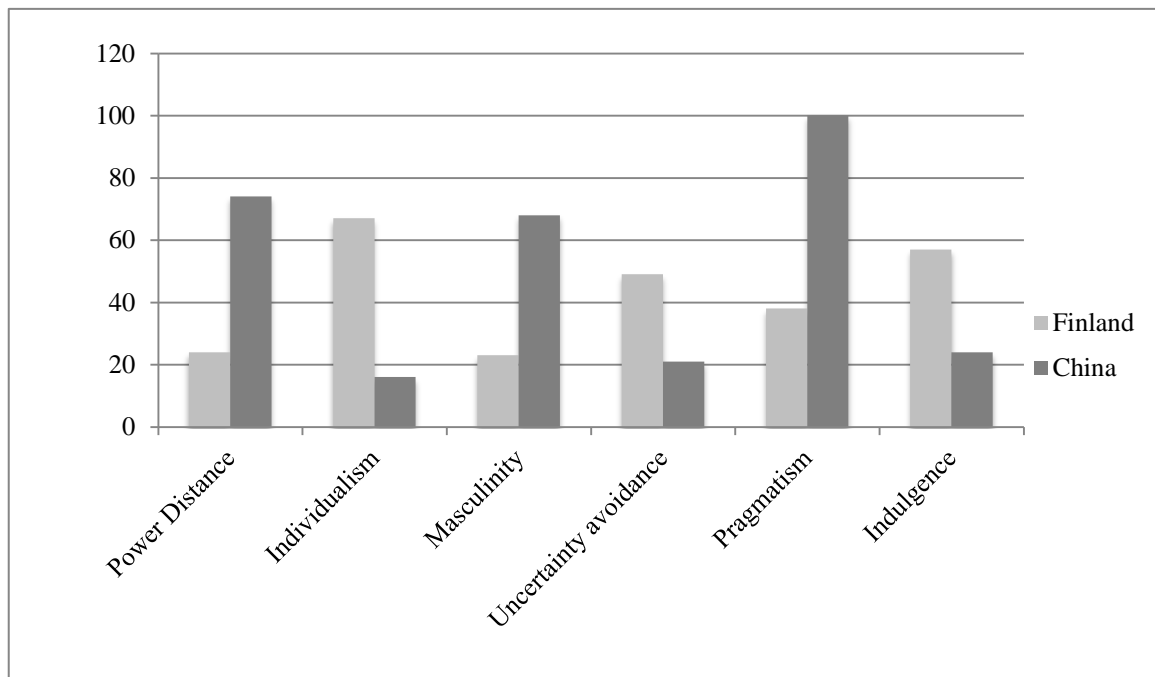
#### 4.2.1. National culture

Culture is what distinguishes us from people in another country. Culture is very deeply rooted in the human society and it is shared by people who live or have lived within the same social environment. Therefore countries differ in their cultures. Foreign firms entering into the emerging markets and wishing to do business in them need to understand the local culture so that they are able to compete with the local players, appeal to consumers and successfully do business with local partners. The differences in the markets between emerging markets and western countries often highlight the cultural differences. (Cavusgil et al. 2013: 50-51.) One of the main aspects in concerning culture is the high cultural distance between Western countries and the Asian market. The collectivistic culture in Asian can present difficulties for foreign firms coming from an individualistic culture. Whereas, the collectivistic culture aims for group harmony, the individualistic culture searches for quick personal gains. In collectivistic cultures, family and the “in-group” that a person belongs to is very important and it requires life-long loyalty towards this group. This often means that people from the “out-group” have often difficulty getting into the society and the different networks. In companies, employee’s dependence on the organization is often stressed and people often tend to have life-long careers in a single organization where as in individualistic countries the employee’s independence from the organization is seen as more important. (Hofstede et al. 2010: 90-101.)

“National culture defines cooperative norms and values and the general level of trust toward stranger in a given society”. This means that culture is behind the behavioral expectations or beliefs concerning the legitimacy of informal relationships. Often cultures are divided into individualistic cultures and collective cultures using Hofstede’s definition. In collectivistic cultures the emphasis is on cooperation, the group and harmony. Despite all the changes in the institutional environment, national culture is relatively stable. As China is a collectivistic country this can mean that networks and the emphasis on relationships will continue to be pervasive in the business environment even as the formal institutions continue getting stronger. (Zhou & Peng 2010: 362.) National culture also impacts the organizational culture in firms and organizations. Many Chinese

companies feel that their biggest challenges in operating in the global marketplace come from their organizational structure that is still a reminiscent from the socialist period. The organizational culture is far from the modern business culture of the West. The issues with language as well as the differences in the way of thinking are things that complicate doing business with the Chinese. (Kosonen 2011: 31, 39.)

The vast cultural differences between Finland and China are visible in Figure 4 which shows the both countries measured on Geert Hofstede's dimensions. Finland is clearly an individualistic country and upholds many contradicting values compared to the Chinese society. When comparing the countries it is apparent that they are almost the opposite of each other.



**Figure 4.** Comparison of Finland and China according to Hofstede's dimensions (Hofstede 2014).

In Finland hierarchy in a business is mainly just for convenience, employees expect to be consulted and managers rely on the experience of their team members. The culture is highly individualistic and people focus mainly on themselves and the immediate family. Equality between people and genders is highly valued, conflicts are solved through negotiations, free time is also highly valued and people work to live. Punctuality and precision are the norm and time is a resource not to be wasted and quick results are often

sought after. In China the situation is the complete opposite. Hierarchy is very high and the culture is collectivistic meaning that people act in their interest of the group and highly valued relationships. People are driven by success and sacrifice their time to work. Chinese people are comfortable with ambiguity and look at time as a flexible resource. (Hofstede 2014.) There is also the concept of high versus low context cultures to be considered. China is a high context culture meaning that in communication the message is often very indirect and implicit, less is said and the underlying message that is left unsaid is expected to be understood by other participants. The emphasis in the conversations and communication is often on relationships where as many of the Western countries including Finland are defined as low context cultures where the communication is very direct, clear and explicit and the emphasis is on the task at hand. (Cavusgil et al. 2013: 53-55.) These clear differences in culture can cause frictions between parties when doing business and require that the parties are willing to try and understand each other.

According to Finpro – China (2014), the Chinese are very proud about their ancient history and culture, so doing business in China requires an understanding and respect of those traditions. Family and business are very strongly linked and people often have a very collective way of thinking. This means that final decisions are made in consensus after several discussions. In general, Chinese people are very secretive when it comes to discussing financial information. In order to do business in China, you need to create a strong bond with your Chinese partner as the Chinese only commit to a business relationship after careful consideration and researching. It is very important for the Chinese to create a trustworthy relationship. Only after a healthy relationship has been established can the business transactions start, prior to that no business transactions will be committed. In order to become a trustworthy partner one must be prepared to spend time during the first meetings and answer even some fairly personal questions. The relationship will grow over time and is built on mutual business interests. Also exchanging business favors is a strong part of the Chinese business culture. It is important to note that even though exchanging favors is acceptable, bribery is strictly forbidden. The Chinese business structure is very hierarchical and senior members are highly respected so senior members generally lead all discussions and have the final say in business deals.

The Chinese have a very non-linear time perception compared to the Western countries, which most have a linear time perception. For the Chinese time is not a scarce commodity, unlike for the Western people. Western people tend to make decisions rationally, are very time conscious and act very straight forward whereas the Chinese are guided by

intuition and their emotions. (Jansson et al. 2007: 960.) This amongst the other differences in the business cultures and in the ways of doing business can often create frictions in the business interactions between the Western and the Chinese.

#### 4.2.2. The importance of relationships and networks

Networks and relationships play a significant role in the Chinese business environment. The lack of developed formal institutions has made the relationships and networks you create in the market extremely important. In China, the formal institutions such as legal frameworks and intellectual property rights systems are underdeveloped and even when developed they are under-enforced. For this reason informal institutions such as networking are needed to facilitate economic exchanges. (Luo 2003: 1316.) According to Peng (2003: 284) during the early phase of institutional transition in the emerging economies, when the formal rules have not been well established, firm's strategic choices are heavily network based and relying on strong personal ties. "Strong-tie-based relationships with both business partners and government officials are more pervasive in Asian countries such as China, Indonesia and South Korea, due to both institutional voids and cultural heritages" (Peng & Zhou 2005: 323; Peng & Luo 2000). The level of using managerial ties has a positive impact on firm performance in China. People rely on their contacts with government officials and with other firms and people with power to get things done rather than on the law. (Luo 2003: 1315.)

This makes network-based strategy the best strategy when entering into the Chinese market as personal trust and informal relationships between managers allow firms to overcome constraints in the institutional environment. The Chinese markets are organized in a network like structure making networks and relationships the main way of doing business. China has its own unique context in which personal ties are used to substitute the lack of formal institutions. In China, the importance of being in a network is becoming a trusted member in the network. Individual and social trustworthiness is the key element in gaining access to the Chinese business networks and in formulating business relationships with the Chinese. Due to the fact that legal institutions cannot be trusted in transactions, the trust between two parties is crucial and is used to guarantee the transaction. Therefore trust in the Chinese market should not be taken for granted and it is important to note that trust is highly based on individuals rather than on the organization or profession. (Jansson et al. 2007: 959, 963.) Networking is not only to respond to the voids and threats created by the under functioning formal institutions but to also gain opportunities. Opportunities in the emerging economies such as China are of-



ten controlled by government officials or by executives in other firms and personal ties with these people are necessary to obtain these opportunities. Networking can help a company achieve more institutional support that will then help with the challenges arising from the uncertainty in the market as the institutions are in transition. Especially in the fast growing industries the need for managerial networking is greater than in a stagnant industry. This is because firms operating in a fast growing industry depend heavily on the supplier, regulators and distributors in order to get quality products and services to the end-user. (Luo 2003: 1317-1319.) It is believed that the Chinese business network collectively controls the wealth and resources in almost all the Asian countries. Through privileged access to policy- and decision makers firms in these networks have both high market power and social and political capital. (Delios & Singh 2005: 67.)

Even as these policies are changing and regulations concerning foreign firms are becoming more liberal, building relationships with the various local government agencies and local businesses and forming political ties is still crucial for firm survival. Although the Asian economies are moving towards a more market-based economy, governments still play a vital role in the business environment thus impacting firm performance with regulations and guidelines. Because of the continuous transitions in the Asian emerging markets, there are diverse policies towards foreign firms, even in single countries (Chen et al. 2010). Political ties are often viewed as a strategic asset in the Asian markets as they can help to secure regulatory resources. Political ties with the host-country government have the ability to improve firm performance by helping them bypass limitations and gain tax incentives and resources that help to build a competitive advantage and improve the financial performance of the firm. Political ties can also cause harm to firm performance. As the Asian countries are becoming more market orientated, business ties become more important in providing resources and helping with knowledge sharing and cooperation, which political ties can inhibit. Strong political ties can have other negative impacts such as firm's reputation being affected badly by government scandals and corruption. (Sheng et al. 2011: 3, 11.)

In the Chinese market, relationships are highly important and are highly personalistic. Building a relationship and establishing the grounds for a long-term relationship are often viewed by the Chinese to be more important than just establishing a common ground for business transactions. First you need to build the foundation of a long-term relationship and then the business transactions will follow. These relationships are socially strong and made to last for a long time. (Jansson et al. 2007: 959-960.) This relational emphasis in China is also known as "guanxi". Guanxi refers to the concepts of

networks to secure favors in business relations in the long run. Guanxi is established by continuously reciprocating favors and through them and the reinforcement of the relationship, building trust. Guanxi can help obtain resources and facilitate knowledge transfer within the group. Building good guanxi can help firms save in transaction costs such as contracting costs, information costs and searching costs. As a consequence of guanxi, personal ties and trust are often viewed more important than legal systems. In the Greater China area (China, Hong Kong, Taiwan, Macau and Singapore) guanxi is a key strategic factor affecting firm performance and all firms eventually subject to its impact through joint operations and local partners. It is said that in China, business strategy depends on guanxi and therefore foreigners face difficulties operating in the market without network connections. (Luo & Chen 1997: 1-5, 14; Cavusgil et al. 2013: 59.) This can be hard for Western firms to understand as these kind of close relationships are mainly associated with family or amongst friends. It is common for Western managers to have a rather negative image of guanxi as these types of very close business relationships are often linked to unethical, illegal and corrupt behavior. (Luo 2008.) Chinese business networks can be very closed and hard for foreigners to enter due to close connections of the network members such as family relations and the favors. Tight guanxi networks can be very secret and hard to see for foreigners and this lack of transparency is often related to corruption that is very prominent in the Southeast Asia. (Jansson et al. 2007: 962.) Guanxi has the ability to affect all dimensions of firm performance so it is crucial for firms to understand the important role of it.

However, it needs to be noted that foreigners often face great difficulties when trying to enter into the Chinese networks. Even as network connections are hugely import in the Chinese market as without them access to information and overall doing business there is difficult, foreign companies are not able to benefit from their managerial ties in China as domestic companies are. Foreign companies often start to experience decreasing returns compared to the input into local relationships after a certain point whereas domestic companies enjoy only rising returns from their ties. Also the building of these trusted relationships and tight connections require quite substantial investments from firms in both time and money. Some relationships can be harmful as firms get too reliant and focus on their existing relationships and forget to look outside of their networks for information and opportunities. (Cavusgil et al. 2013: 59; Li, Poppo & Zhou 2008: 383, 385-389.) As the economy develops towards a more market-orientated environment, managerial ties will have a decreasing impact on firm performance (Peng 2003: 292).

#### 4.2.3. Corruption

Corruption has been referred as a big concern in many Asian emerging economies for foreign firms. Informal institutions are often characterized with corrupt practices and as informal institutions have been used to fill the gap created by ill-functioning formal institutions, the structures governing and enabling corruption have become the critical force affecting all business in the environment (McGuinness & Demirbag 2012). Illegal business-government links as well as business-business links for personal monetary or resource gains are predominant in business in the Asian region. These problems in the business environment can be hard to eradicate as the formal institutions concerning corruption are constantly and rapidly changing. The lack of government practices on transparency and strong institutions to fight corruption increase difficulties in the situation. In many Asian markets, corruption is used for power gaining purposes as power cannot be gained from the law but from relationships that are formulated through corruption. Several Asian economies rank high in the Transparency International's corruption perception index (Appendix 2) and Chinese companies are together with Russian companies the most prone to take bribes on an international comparison. The IPR Index ranks China 91st out of 130 countries on the control of corruption that measures the extent to which power is used for private gain. All in all corruption is estimated to amount up to 3 to 5 percent of China's GDP and that around 10 percent of the public funds is spent on bribes. (Transparency International 2014; Kosonen 2011: 36.)

In Asia, corruption is based on the strong ties between government officials and family businesses that are formed to protect family businesses, but at the same time this arrangement feeds corruption. (Luo 2002: 113-132.) Corruption in China has been the highest in business and in the regulative part of the government as well as in the police and government officials. For foreign firms, government corruption creates a whole range of direct costs in the form of bribes, red tape, and avoidance, the foregoing of market supporting institutions and in the worst case the engagement of organized crime. There are also indirect costs such as reduced investment, distorted public expenditure, economic weakness and instability, weak infrastructure and socio-economic failure (Doh, Rodriguez, Uhlenbruck, Collins & Eden 2003.) These costs can be very hard to see and quantify due to the lack of transparency in the market. China has started multiple campaigns against corruption and even has a Central Commission for Discipline as the monitoring government body for corruption. In 2013 China's president Xi Jinping started a campaign to eradicate corruption from China, as the corruption is so widespread that it has been feared to do damage to the Chinese communist party. So far the

process has been slow and only the smaller, middle management officials have been caught, but the big players are still free. In China the maximum punishment for corruption is death. But still corruption in China has stayed relatively the same for the last decade or so despite of these campaigns and hard punishments. (Kosonen 2011: 36-37; CNN 2013.)

Corruption in China is very problematic as it is very embedded in the Chinese culture and especially with *guanxi*. For example gift giving is viewed as a sign of respect instead of corruption. Still the main issue with corruption is that even as there might be formal rules but no resources to enact these rules. For this reason many people turn to their *guanxi* connections and foreigners with a lack of understanding towards *guanxi* and business relations can be in a poorer position. (CNN 2013.) Corruption has the potential to be very harmful for foreign firms and as it can be very hidden it can be hard to discover in the market. Especially local firms and firms with joint ventures can end up justifying corruption as it can be seen as the way to do business in certain areas. Corruption creates both visible and invisible damages that can be hard to compensate even with time.

Not only can corruption have a very negative impact if the firm is somehow involved in it, knowingly or unknowingly, but also when firms decide to not participate in corruption. This can mean that a firm not willing to participate in corruption can lose deals, as there can be a Chinese competitor willing to participate. Not participating in corruption can mean that your orders are stuck in customs for lengthy periods of time as the customs officers expect you to pay them to move your order quicker. (Kosonen 2011.) By letting your order sit in customs a firm can lose valuable production time and in the worst case end up delivering the end product late and facing possible penalties for possible contract violation.

The likelihood of foreign firms investing into the emerging economies confronting corruption is much higher than any other political risks. This is because corruption exists below the radar for corporate officials and even to government officials. Corruption has both direct and indirect costs. Direct costs are the results of direct interaction the firm and government such as bribes, bureaucratic red tape and other transaction costs. Direct costs also include the costs created by possibly expensive efforts to avoid a limit firm exposure to corruption. Some firms have even opted to rather close their plants in a certain country to avoid paying bribes to local customs officials. Firms might be forced to participate in unproductive behavior such as hiring key city officials or their relatives as

workers to develop their political influence. Corruption also limits foreign firm ability to use courts to help them enforce contracts. Indirect costs from corruption come from public sector failure such as weak institutions, ineffective use of public resources and government policies retracting economic growth. These costs cannot be specifically identified but can result in higher prices of resources, lower profitability prospects and macroeconomic instability. Unlike the direct costs, these indirect costs are often overlooked by firms as it can be hard for firms to estimate how these costs affect them. Two dimensions of corruption can be identified: pervasiveness and arbitrariness. Pervasiveness refers to the level of corruption and reflects the number and frequency of corrupt transactions that firms deal over time. In some countries corruption is often predictable. Another characteristic of corruption is arbitrariness when government agents act independently to maximize their own bribe revenue and leaving firms uncertain whom to pay, what to pay and will the promised result come through. China ranks low in arbitrariness but high in pervasiveness meaning that there is an organized group gathering corruption and corruption payments and costs can be referred to as paying taxes. (Doh et al. 2003: 114-119.) Table 5 summarizes the findings made in the informal institutional environment of China.

**Table 5.** Factors of the informal institutions affecting foreign firm performance in the emerging economy of China.

**Factors negatively affecting foreign firm performance:**

- High cultural differences: difficulties in decision making and management, communication and language
- High dependency on networks
- Corruption

**Factors positively affecting foreign firm performance:**

- Networks and relationships as the substitutes for weak formal institutions, helping provide information and resources
- Trust and creating strong, long-term relationships

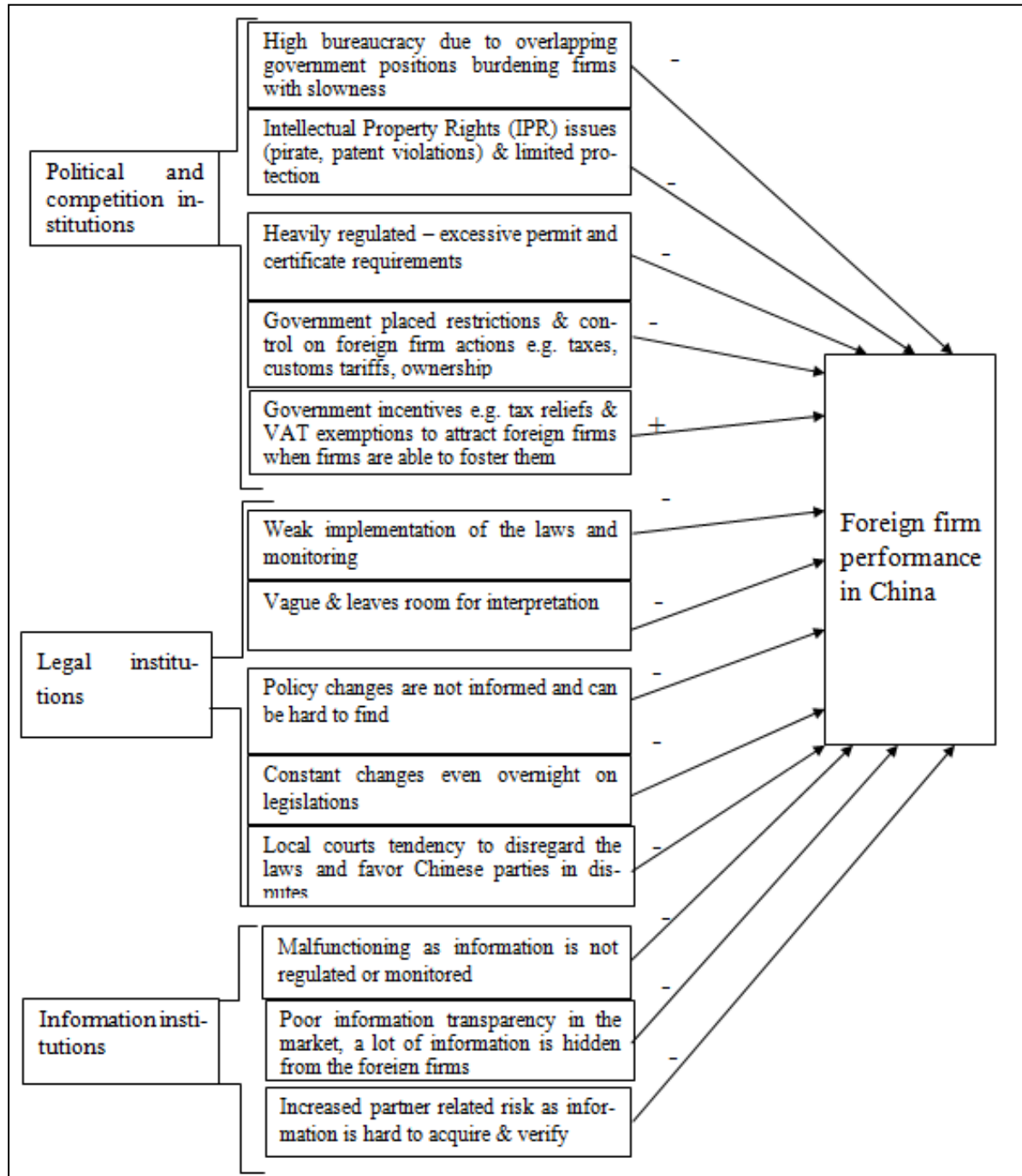
### 4.3. Summary

There are various factors in the institutional environment of the emerging market of China that impact foreign firm performance when operating there. The biggest factor is the constantly changing nature of the institutional environment. These changes affect both the formal and informal institutions, which then impact firm performance both negatively and positively.

There are obvious costs that come from operating in an institutionally unstable environment. Often the costs of governing a firm are much higher than in developed countries but firms also might be forced to share the ownership, control and profits with a partner or the host government. The higher costs are partly created by the institutional uncertainty, as it requires increased monitoring and enforcement costs, and as more contracts need to be made to protect firms when the formal institutions do not offer protection. Extra time and resources must be spent on monitoring the regulative environment that can change rapidly. (Luo 2007: 41.) These extra costs can have a negative impact on firm performance. Due to the difference of the markets it has been shown that it can take a few years before a foreign firm becomes successful when operating in an emerging market.

The impacts of the formal institutions were, based on the previous literature, mainly negative whereas the impacts of the informal institutions were more positive if a firm knows how to foster them. There can still be a lot of government interventions in the business environment of the emerging markets meaning that firms and their actions are limited by a number of restrictions or the tendency to favor local players. There procedures involving business are often very complex, bureaucratic and expensive creating many different trade barriers. The developing legal institutions create some of the biggest challenges for firm performance. Firms suffer from extra cost created by the need to protect themselves through contracts and increased monitoring as the legal environment is weak and lacks enforcement. This is especially apparent with intellectual property rights, which many firms name to be the biggest issue in the Chinese market where their IP is not protected leaving firms open to piracy and copying. Information asymmetries create strains for firm performance as explicit and quality information can be difficult to gather. The difficulty of gaining access to information also creates the extra costs of verifying and gathering information. On the other hand government incentives on performance can help improve firm performance through e.g. tax reliefs. From this the

following framework (Figure 5) can be formulated were the positive (+) and negative (-) impacts are shown.



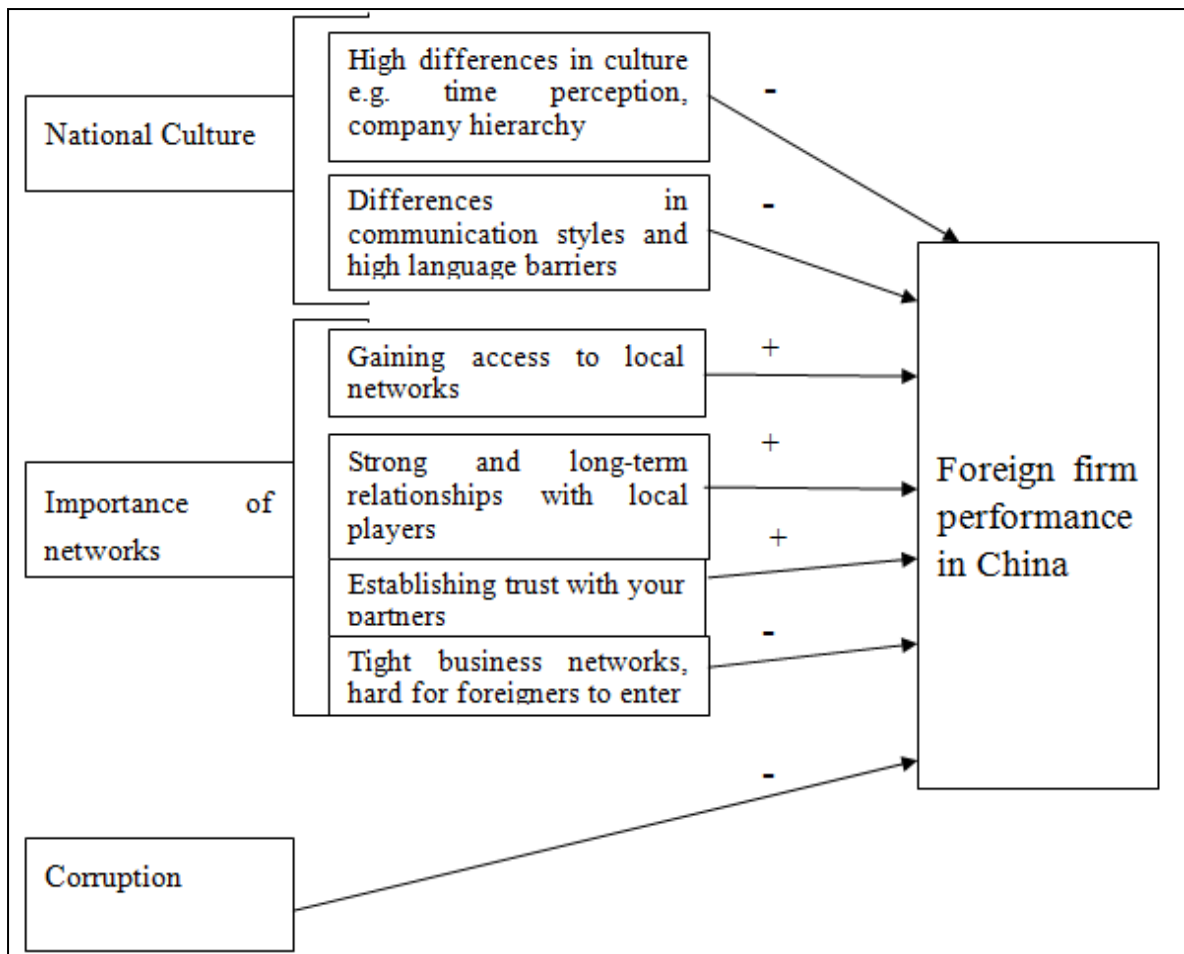
**Figure 5.** The impact of the formal institutions.

The Position paper 2013/2014 assessing European business in China states that in order for China's economy to continue growing, a new round of structural reforms is needed.

Whereas previously China had a choice between economic restructuring and maintaining growth, now it needs to focus heavily in economic restructuring in order to maintain growth. The Position paper suggests that the role of the government as a regulator needs to be strengthened in order for it to become more efficient to better empower regulatory implementation and enforcement. But at the same time the government control over the financial system and industrial policies should be reduced to able the functioning of market forces.

The informal institutions impact foreign firm performance greatly through the connections, relationships and networks that firms are able to create and participate in. Figure 6 shows the impact as either being negative or positive. Cultural differences are high when comparing China and Western countries on Hofstede's dimensions. These differences often originate from the differences in thinking, values, hierarchy, communication and also from language barriers as English still not a common language in China. These cultural differences can create strains when operating together with a local partner as both parties can have different objectives, goals and performance criteria. These differences can create various problems ranging from opportunism to liability of foreignness. Strong relationship emphasis in the Asian market can improve firm performance as personal ties play a critical role in a firm's ability to gain resources and knowledge. Due to the relationship emphasis, many firms often formulate different business networks. The traditional institutions of *guanxi* were proven by previous studies to have a positive impact on firm performance. Political ties with the host country government can have both negative and positive impacts as they can damage firm image and inhibit knowledge sharing or help them gain more resources and bypass some inspections and limitations that would be placed on their operations without these ties. Corruption also has a negative impact on foreign firm performance as it can harm business practices and their image. It is important for firms to critically assess the relationships they formulate with both the businesses and the government in the host country. In China these relationships are considered crucial for firm success but due to cultural differences the managers of foreign firms might not understand the role of these relationships and the benefits they can gain from them and only see them as a waste of time and other resources. It is also important for firms to set the boundaries for themselves on what these relationships mean, how important are they and what are the limits of that relationship to try and avoid from participating in corruption or bribery.





**Figure 6.** The impact of informal institutions

Both formal and institutions have strong and multilevel impacts on foreign firm performance as they strongly affect their strategy and performance. The effects of the institutional environment vary greatly by country and its government and culture. Even within the Asian emerging markets, the institutional environments are diverse. At the moment, it may seem that the impacts of the institutions are mainly negative but with managerial and strategic adaptation firms have the ability to bypass the negative effects and succeed in the Asian emerging markets.

## 5. METHODOLOGY

This chapter focuses on presenting the methodology of this study including the description of the research approach, data collection and the data analyzing methods. Finally the validity, reliability and ethics of this study are discussed.

### 5.1. Research purpose and approach

Before conducting a research, it is important to define what the research purpose is and what the objectives of the study are to then better define, which research approach is the most suitable. Research purpose is often classified as being exploratory, descriptive or explanatory. An exploratory study aims to find out “what is happening” and assess a phenomenon in a new light. It is conducted in three ways: a search of literature, interviewing experts or by conducting focus group interview. A descriptive research aims to “portray an accurate profile of persons, events or situations”. An explanatory research aims to establish causal relationships between variables. It is important to bear in mind, that even as the research purpose can be classified into three different groups, the research project can have more than one purpose. (Saunders, Lewis & Thornhill 2009: 140.)

The research purpose of this study is exploratory as well as explanatory. This study is exploratory as it aims to assess the phenomena of the institutional environment of the emerging market in a new light and use literature as well as expert interviews in this assessment. As this study also aims to understand the causal relationship between institutions of the emerging markets and foreign firm performance the purpose is also explanatory.

Research approach is concerned in the way in which the use of theory is involved in a research. The research approach can be defined as being either deductive or inductive. In a deductive approach the existing theory is used as the basis of the research hypothesis and it guides the research whereas in an inductive approach the theory is generated out of the research results. A deductive study aims to explain causal relationships between variables and the research methodology is often highly structured and the results are generalized. An inductive study on the other hand aims to gain a close understanding of meanings and the nature of the problem. Deduction and induction can be com-

bined in a research. (Saunders et al 2009: 125-127.) The research approach chosen for this study is deductive. The theoretical framework of this study is of a deductive approach, built on former research and literature and from there the theoretical framework for this study was built. By using a deductive approach this study aims to explain causal relationships between different institutional actors and firm performance visible in current scientific theories. This study continues from this deductive approach to uncover individual experiences of the phenomenon of institutions impacting firm performance through qualitative methods. (Ghauri & Grønhaug 2005: 110-111.)

## 5.2. Methodological choice

Before the empirical part and the data collection of the study can be conducted, it needs to be decided how it will be collected and analyzed. The chosen data collection technique should align with the main research question and objectives. Research is traditionally divided into qualitative and quantitative research. This is because the data collection and analysis methods differ in these two types of research. Qualitative data is based on meanings expressed through words, collected data is mainly non-standardized and the analysis is done through conceptualization. In a qualitative research the researcher is often closely involved with the respondents thus having a chance to gain a deeper insight into the research phenomena. Quantitative data is based on meanings derived from numbers, collected data is numerical and standardized and the analysis of this data is done through diagrams and statistics. (Saunders et al. 2009: 151, 482.) The main difference is that in a quantitative research measurements are involved and in qualitative they are not (Ghauri & Grønhaug 2005: 109). Whereas qualitative research aims to explain, describe and forecast a certain phenomenon and answer questions such as how much, how many or how often, a quantitative research aims to understand and interpret and answer questions like what or why (Cooper & Schindler 2011: 160-163). A strict distinction is important but it can also be seen as problematic and narrow as in business and management research it is common to mix elements of both methods (Saunders et al. 2009: 125-127).

The chosen method for this study is the qualitative research method as the main research question aims to understand how institutions impact and gain a deeper insight into the concept of the institutional environment. By using qualitative data collection methods it is also possible to gain a longitudinal perspective into the study and gain an understanding of changes over time. The use of quantitative research methods would

not necessarily reveal the complexity of the phenomenon as it uses a much more simplified response process of questionnaires. (Saunders et al. 2009: 155.)

Furthermore, this research is based on case studies because the focus is on a current phenomenon and hopes to examine this phenomena in a real-life context to help answer the question of how institutions impact (Ghauri & Grønhaug 2005: 115). Case studies are one of the most common methods of qualitative research and can be divided into three different types: intrinsic case study where the focus is on understanding a particular case, instrumental case study where a case is examined to provide insight to an issue and collective case study where multiple cases are examined to investigate a phenomena. (Stake 2005: 443-445.) This study will use the collective case-study method meaning that a number of cases are investigated to understand a phenomenon. A case study is also used as it is traditionally done through a review on existing material and interviews (Ghauri & Grønhaug 2005: 116). A qualitative research method is very suitable in an international setting where there are often vast cultural differences. These differences affect the reality of the firms that is created through social interaction. (Silverman 2000: 823.) As this study is conducted from the viewpoint of Finnish companies it is important to take into account the cultural differences as well as the institutional differences that are both very concrete for Finnish companies as they operate in China.

### 5.3. Sampling, data collection and analysis

The sampling for this study was done through purposive sampling. The cases and the interviewees were selected based on their similarities and accessibility. All of the case companies are Finnish multinational companies that have a long history of operating in China and state China to be one of their most important market. They are all part of the Cleantech Finland collaboration that aims to promote Finnish cleantech technology and knowhow in the world. The interviewees from these companies were chosen by determining their ability to answer the research questions. All of the interviewees have had extensive experience with operating with the Chinese market and all but one have lived in China for over two years and have spent considerable amount in China and visit the country regularly almost monthly. Purposive sampling is typically used when particularly informative cases are sought after as this type of sampling allows a reasonable control over the sample contents (Saunders et al. 2009: 237-240).

The data collection for this study was conducted over the course of three months. First initial data was collected from secondary sources such as company reports and publications. After this the interviews were conducted. The chosen qualitative data collection method was interviews because this allowed the researcher to focus on a small sample of subjects and it allowed the gathering of valid and reliable data that is relevant to the research questions and objectives (Ghauri & Grønhaug 2005: 140-142).

The interview technique used was semi-structured interviews conducted between January and March 2014 face-to-face at the case companies in Vaasa and Vantaa, Finland and the questionnaire used can be viewed in Appendix 3. The semi-structured interview technique was used as the questions were prepared based on the theoretical framework as well as on secondary data but as the main aim of this research was to see if the framework is applicable in the business environment, this technique enabled the interviewer to leave out or change the questions during the interview, depending on the circumstances. This unstructured approach allowed the researcher to concentrate also on the possible unexpected topics that may rise in the interview session. Moreover, this technique allowed the interviewees to explain and build their responses and there is a possibility to ask additional questions to gain clarifications and to increase the likelihood of gaining the information that was sought after. (Saunders et al 2009: 320-323.) Four Finnish based energy companies operating in the cleantech industry were contacted through their HR departments in regards of the possibility to interview them. After introducing the topics of this study, the HR departments suggested or contacted persons most suitable for the interviews. In total 5 managers participated to the interviews and will be further introduced in chapter 6 where the case companies are presented.

The interviewees varied in the period of time worked in the company as well as in their age and experience. This and the background of the interviewees impacted the answers given as well as in the length of the interviews. The interviews were all conducted in Finnish as all of the interviewees were of Finnish nationality. This was to help minimize the effects of possible language barriers. The interviews were audio recorded and additional notes were taken during the interviews in order to avoid the loss of important data. The same questions were asked from all of the interviewees, however changing the order of the questions as well as asking clarifying questions depending on the flow of the conversation as well as the answers given. The questions were not requested beforehand by any of the interviewees, only the topic of the interview was explained when setting up the interview appointments.

When analyzing the data it is essential to be objective and non-selective about which data to report. It is also important to make sure that the participants' responses are kept confidential. The interviews were recorded and then transcribed into text by word-to-word and the direct quotes used later in this study are translated by the author of the thesis. The transcription was done prior to the analysis of the data to help recollect the conversation and track smaller details (Silverman 2000: 829). After transcribing the interviews the material was grouped into different themes and concepts. The final stage of the analysis of data was pattern matching, where the theoretical framework formulated on the basis of prior literature was compared with the empirical data in order to deduct new patterns and remodel the theoretical framework. (Saunders et al. 2009: 500.)

#### 5.4. Reliability, validity and ethics of the study

Reliability refers to the repeatability and consistency of the data collection techniques and analysis procedures used in a research. High reliability means that other observers will be able to reach similar observations and the measurements will give the same result if done again. Reliability also refers to the transparency in how sense is made from the raw data. (Saunders et al. 2009: 156-157.) Interview questions used in this study were based on former research related to the subject in order to increase the reliability of the study. In order to increase reliability, questions were clarified when needed so that the risk of the respondents not understanding the questions was minimized. Validity measures whether the findings are really about what they appear to be about (Saunders et al. 2009: 156-157). To improve the validity of this study multiple sources of data were used. All of the companies operate in the same industry thus increasing the possibility to attempt generalization of the study within the industry. Reliability and validity in the research design help reduce the possibility of getting the answer wrong. When using semi-structured interviews as a method there can be data quality issues such as validity and generalization, reliability and forms of bias (Saunders et al. 2009: 156-157, 327).

Generalizability or external validity is often an issue in qualitative data collections due to the small unrepresentative number of participants (Saunders et al. 2009: 327). Due to the time constraints and the lack of resources the results of this thesis may not be easily generalizable. Also, as the data has been collected qualitatively, the results are not to be as generalizable as data collected through quantitative methods. The reliability and validity of the study were affected by the lack of experience of the researcher. As the re-

searcher of this study had no previous experience in doing scientific interviews it is possible that this resulted as incorrect questions and the possible lack of some important questions. There can have been an inability to go sufficiently deep into some issues. The data can also have been affected by the fact that during the first interviews the theoretical framework was not totally complete and this allowed the researcher to keep a more open mind and discuss the themes more freely from the interviewee's viewpoint. In the later stages of the study the researcher was able to expect certain themes and issues to rise up in the interviews so there might have been some bias towards gaining certain kind of results to support the previous findings. To improve the credibility of this study the interviewees in this study were from different companies, which means that the study was able to benefit from multiple points of view. All of the case companies have established operations in China at different point in time and they operate in various different sectors and locations in China.

When doing a research, the researcher has a moral responsibility to execute the research and explain the answers to the research questions honestly and accurately. This means that the both the strengths and the weaknesses of the methods, models and results need to be pointed out, so that the readers are not mislead by the results. (Ghauri & Grønhaug 2005: 20, 22; Wilson 2010: 81.) The general ethical guideline for this study was that the research design of this study will not subject the targets of this research to embarrassment, harm or any other material disadvantage (Saunders et al. 2009: 160). This means that the privacy and confidentiality of the participants was to be respected (Wilson 2010: 81). It is important to note that face-to-face interviews can involve ethical and reliability issues. Saunders et al (2009: 194) note that in face-to-face situations the researcher has some power over the interviewee through question formulation. Reliability can be compromised as the way the questions are asked may influence the reply of the interviewee. In order to avoid these issues, the researcher prepared thoroughly for the interviews by conducting a pilot interview to ensure that the questions are appropriate. To minimize the ethical issues that can arise from using face-to face interview, it is important that the individuals involved in the research are not deceived about the researcher's true purpose. The participants have the ability to withdraw from the research at any time or decline from answering any questions they feel uncomfortable with. They also have the option to remain anonymous if they so wish meaning that their name will not be revealed. The main aspects of the research and the aim of the research will be explained to the interviewees at the beginning of each interview and the rights of the interviewees will be discussed. (Saunders et al 2009: 190- 191; Wilson 2010: 88.)

## 6. RESULTS AND FINDINGS

This chapter discusses the results gathered from the data collected through the interviews in order to highlight the key findings of the study. The chapter starts with a short introduction of the case companies interviewed for this study and then continues into assessing the results of the interviews through the formal and informal institutional factors found in the Chinese market in the previous theoretical chapters. Finally, the results are combined and the main findings will be discussed.

### 6.1. Introduction of the case companies & cleantech

For this thesis, four Finnish companies were interviewed and from these companies, 5 people were interviewed. These companies were The Switch, Vaisala, Wärtsilä and Vacon and their main figures are gathered in Table 6. All of the companies operate in the energy industry and provide different solutions and products that are used in cleantech. The pilot interviewee was Dag Sandås, the CFO of The Switch. The Switch is a Finnish company established in 2006 by the merger of three companies: Rotatek Finland, Ver-teco and Youtility. The Switch is focused on the business potential of renewable energy resources and operates in businesses such as wind power, solar power and marine business. The Switch provides products and systems to be used as a part of their customers' machines or systems in wind turbines and other renewable energy and energy conserving applications. The consolidated revenue in 2012 was 43.2 MEUR and the Switch operates in Europe, North America and China, India and South Korea with the total personnel of 210. (The Switch Annual Report 2012.) The Switch has been awarded by the Global Cleantech Cluster Association for their achievements in wind power (GCCA 2013). The company started their operations in China in 2007 and today have there five offices, in Beijing, Hong Kong, and in Lu'an where they also have a production site that is stated to be "a real example of our commitment and footprint in Asia". China is the main market for The Switch. (The Switch Annual Report 2012.)

The second case company, Vaisala is "a global leader in environmental and industrial measurements" providing high-quality equipment and solutions to help predict weather and help life science companies to establish and maintain consistent environmental conditions. Vaisala also operates in the renewable energy market by providing observation data to secure and optimize the operations of hydro, wind and solar power plants such



as wind measurement and weather monitoring. (Vaisala Corporate Brochure 2012.) Vaisala is a Finnish company started in the early 1930's by Vilho Väisälä and today has close to 30 offices around the world in Finland, China, India, Japan, the UK, the US and Australia, Canada and the United Arab Emirates. Vaisala employees over 1400 people and in 2012 their consolidated revenue was 293 million. (Vaisala Corporate 2014.) In China Vaisala has two offices: in Beijing and Shanghai. The first office in China was established in 1994 and the company had started doing business in China a few years before. (Interview Marko Mäkinen 2014.) Vaisala established their subsidiary Vaisala China Inc in 2005 due to the growth of the Chinese market (Vaisala Press 2006). In 2013 Vaisala purchased a US originated company 3TIER Inc specializing in evaluating and predicting renewable energy production. This will further help Vaisala establish their position in the renewable energy market especially in Brazil, China, India, Australia and the US. The renewable energy-market is one of Vaisala's Weather-division strategic focus areas. (Vaisala Press 2013.) The interviewee, Marko Mäkinen, is the Director of Sales of China in the Vaisala Weather division and has spent the last two year in Peking managing Vaisala's China's sales operations and returned to Finland in the beginning of 2014.

The third company, Wärtsilä, is a Finnish corporation providing complete lifecycle power solutions for the marine and energy market that help their customers gain high efficiency with low environmental load. The company was founded in 1834 as a mill and today operates in 70 countries around the world with the net sales of EUR 4.7 billion and around 18,700 employees in 2013. (Wärtsilä About Us 2014.) Wärtsilä has been present in China for over 20 years, starting from 1982 when the company started to develop agent relationships in Hong Kong and currently is present in the Chinese market through a fully owned subsidiary, long-term licensing agreements and joint ventures and has currently over 2000 employees in eight locations in China. (Wärtsilä – About Wärtsilä in China 2014.) The interviewee, Tomi Vuollet, is a general manager who has just relocated back to Finland from Shanghai where he spent over 2 years.

Vacon, the fourth case company, is a Finnish company established in 1993 that develops and manufactures AC drivers used in electric motors to offer optimum process control and energy efficiency. AC drivers play a key role in the energy production from renewable resources. The company employs globally around 1600 people and in 2013 the revenues amounted to EUR 403.0 million. Vacon has subsidiaries and representative offices in Europe, Middle East and Africa, Asia-Pacific and in North and South America. In Asia Vacon has factories in Suzhou China, established in 2005 and in Bangalore

India. Vacon began operations in China in 2000 and today has local branches in Beijing, Shanghai, Wuhan, Guangzhou, Shenyang and Qingdao. (Vacon - Company 2013.) The first interviewee, Pertti Rajamäki, is currently the Vice president of business development. From 2010 until 2013 he was the Managing Director of Vacon Suzhou Drives. The second interviewee, Mikko Närvä, is a global sourcing manager at Vacon and has been in China, in Suzhou, first in 2007 for 6 months and then again from the end of 2008 until the end of 2010 and today due to his position as a sourcing manager he travels intensively in China.

All companies interviewed for this thesis are part of the Cleantech Finland-collaboration, which was established in 2008 to promote Finnish cleantech know-how in the global market and today consists of around 70 of the top Finnish cleantech companies. The cleantech industry accounts for a large variety of different technologies and manufacturing industries and aims to develop products and services that help to sustain the environment and lower the use of coal. Even small changes in highly polluting industries can help considerably lower their impact on the environment. The main purpose of the Cleantech Finland collaboration is to bring synergy advantages to Finnish cleantech companies and help them locate new business opportunities in the world. Finland has a good reputation as an environmentally clean country and as a location of high quality technology. Currently Finland ranks on the 4<sup>th</sup> place on an index measuring cleantech innovation. Still this knowledge and competitive edge had been hard to commercialize so therefore the collaboration was established to speed the industries growth and bring together the huge variety of cleantech companies and solutions in Finland. Cleantech is currently one of Finland's largest and fastest growing industry with the annual growth of over 15 percent in 2012 and the aim is to grow the industry so that it creates 40 000 new jobs and 50 billion Euros in revenue by 2020. The main market for Finnish cleantech companies is China. (Finpro 2014; Cleantech Finland 2014; Hamilo 2014.) Globally the cleantech industry is one of the most rapidly growing industries with an annual growth of around 10 percent. The Chinese cleantech market grows at around 15 per cent annually and is valued to be worth over EUR 1,100 billion. China has also been very welcoming to cleantech companies as the country is in desperate need for technologies to help with the mounting environmental concerns such as air pollution, food safety and water shortages. (Työ ja Elinkeinoministeriö 2013; Cleantech Finland Slideshare 2010; Forbes 2013.)

**Table 6.** Summary of the case companies.

Company Name	Number of personnel	Turnover	Year of establishment	Internationalized to China
The Switch	210	EUR43,2 million	2006	2007
Vaisala	1400	EUR293 million	1930	1994
Vacon	1600	EUR403 million	1993	2000
Wärtsilä	18700	EUR4.7 billion	1834	1982

In the beginning of the interviews with the managers all of them emphasized heavily the importance of China for their business. For all of the firms, China is one of the biggest markets and it has been one of the biggest markets in the world for the past couple of decades. Especially for the smaller companies, Vaisala, Vacon and The Switch, China is either their largest or second largest individual region and also the market with the most aggressive growth. Vacon even changed their geographical scope of the world into 5 parts where as previously it was in 3, in order to separate China and Korea into a separate market area to emphasize the importance of China to the company. All of the firms felt that it was highly important to be present in the Chinese market and felt that in the future China will continue to grow even more and provide a huge and vastly growing internal market for the firms.

## 6.2. Impacts of the formal institutions

During the literature review and the formulation of the theoretical part of this study, it came apparent that the impacts of the formal institutions are regarded in theory at this moment as mainly negative towards foreign firms. In the formal environment the focus was on the political and competition institutions that reflect the government actions in the market place and the possible trade barriers in the market, the legal institutions focusing on laws, regulations and their implementation and on information institutions that view the regulations regarding the information available in the market. During the literature review it was found that the government places restrictions on firm's ownerships and actions through different trade barriers such as high customs payments. The

business environment in China is said to be heavily regulated meaning that firms need to get multiple permits and certificates in order to operate but this is then hindered by high bureaucracy, especially in the government offices. IPR is a big issue in China for foreign firms as their technologies and products are constantly copied and spread illegally. The legal environment is constantly developing towards a more Western model but this also means that the legal environment is in constant turmoil. This is apparent in weak implementation and enforcement of the laws and in constant and fast changes of the laws and regulations forcing firms to constantly change their actions and monitor the market increasingly themselves as the laws cannot be relied on to provide protection. The information institutions are also underdeveloped and local firms are not encouraged towards transparency and reporting. Foreign firms are forced to find the information they need to make safe decisions themselves in a market where the lack of formal institutions can encourage towards cheating and misbehavior.

#### 6.2.1. Political and competition institutions

Not all firms felt that there are any specific government restrictions in the Chinese market that affect their actions and operations in China. In the Cleantech market itself firms did not feel there were many government restrictions as China is eager to attract the best technology and knowledge available. Wärtsilä had faced several restrictions in their ship building industry due to the fact that it is regarded as a strategically important sector and therefore foreign firms are not allowed to build their own factories but must form joint ventures, mainly with state owned enterprises in order to manufacture in China. Wärtsilä found that the government is surprisingly involved in the process of building the joint venture and clearly stated from the beginning that there is no other option if Wärtsilä wishes to have a factory in this industry. The restrictions also state that these JVs are supposed to be 51-49 ownership so that the Chinese party has the majority. Mr. Vuollet from Wärtsilä felt that this was one of their greatest challenges in the Chinese market, having these restrictions and not being able to have their own factory because it took away the chance to read the management and actions of the factory as an open book. Mr. Vuollet also felt that this requirement of forming a JV put a lot of pressure on the firm and to the selection of the partner if you wish to find a partner who could contribute more to the relationship than just finances and stealing your ideas. Others reported that the situation with the government is such that you often have no idea what the next step is going to be and what can be the possible requirement set on firms. Others also had felt that there are pressures from the Chinese government and the market overall to formulate joint ventures, particularly with local, government owned

partners and that many foreign firms for that reason take upon to formulate JVs. So there is clearly a governmental pressure and aim to control foreign firms and their actions in the market and in some industries firms have no other choice but to form a JV if they wish to operate in China. In the future, cleantech can become a strategically important industry for the Chinese government and this can result to increasing government restrictions on foreign firm actions and the ownership and entry modes possible in the industry. As the emphasis on cleantech increases, joint ventures might become a requirement in the industry to increase government involvement and through that help develop Chinese technology.

Vacon had also found that the government can be very involved in your actions when you wish to establish a factory in China. It was said that it is very surprising the way how involved they are in the process as in Finland, the government does not take such an interest in foreign firms and their actions. Vacon had faced other government restrictions in the form of customs duties. The customs duties within China were reported to be very high. It was said that it can cost the same to ship something from Shanghai to Beijing by road or to ship by boat from the USA due to multiple custom points in China where everyone is charging something when traveling by road. Vaisala and The Switch had also found customs payments and the complexity of the customs procedure as a restricting factor. It was said that the customs duties have during the years come down slightly towards the international level but especially when moving products within China the respondents felt that there were multiple payments in different customs points which made the transportation costs ridiculously high. This also puts into question is it sensible to have a factory in China as the shipment of the products can be even more costly than when shipped from Europe and this is something that the firms constantly assess.

Protectionism was mentioned as a government restriction by Mr. Mäkinen from Vaisala. Kosonen (2011) had also found in her trade barrier study that protectionism seems to be increasing in China. Mr. Mäkinen stated that in the government and in government organizations there is increasing demand and more regulations to use Chinese technology. Mr. Närvä from Vacon also had found that China clearly does have a habit of favoring solutions that have been developed purely in China. Many government institutions such as the China Meteorology Institute have a guideline forcing them to use a certain amount of domestic technology and skills per year and this amount has been increasing in the past years. This is to improve the Chinese technology as well as to boost the domestic market but it restricts the business of foreign firms as they might not be allowed

to complete the whole project on their own or are not even considered for the deal and requires them to think about partnerships with local firms or investing in their own production in order to stay in the game. It was also noted that there has been an increasing demand for the products to be made in China. This increase in protectionism means that foreign firms are increasingly forced to bring production as well as R&D into China in order to continue doing business in the market. The firms that have production and R&D in China said that it clearly improves their business opportunities in China where as firms that do not have production find themselves in a position where they are in some cases out of the competition. Many of them also remarked that it is no longer enough just to have manufacturing in China put you also need to bring in R&D to be able to show that the products are in a sense “really made in China”.

The Switch on the other hand, originally in 2007 when they went to China, built the factory expecting that there will be a market requirement that the products sold in the Chinese market need to be made in China. At the time this did not happen and the factory was unprofitable for years. Even as the factory was running at a loss for the first years Mr. Sandås from the Switch said they decided to not to close the factory due to the cultural concept of “loss of face”. If they had closed the factory then it would have been hard to come and open a new factory later as they would have already lost their face meaning their reputation. Now the Switch is able to answer to this requirement to manufacture in China and has managed to turn their factory profitable. Also Mr. Vuollet had noted this protectionism and said that it is a fear of foreign companies in China and one of the main reasons why Wärtsilä has chosen to formulate JVs in China, to be able to stay in the market if they are closed for foreigners. So foreign firms clearly feel that there is an increasing amount of protectionism in the market and the aim to promote the local producers and bring China’s level of technology up. This poses a potential future threat for all foreign firms now operating in China and restricts the business opportunities of many firms who do not have manufacturing in China. Bigger increases in protectionism can even force foreign firms out of the competition and the market in the long run unless they establish more operations in China or start a JV with a local partner.

Another thing related to the increasing protectionism that was noted by the interviewees is the rises in wages in China. Even as the prices of labor are in some industries and worker groups still relatively lower than in Finland and China has been the country of offshore production due to its low labor costs, today firms in China find that they are paying more for educated people than they do in Finland. The government given guidelines to pay raises were said to be somewhat ridiculous and that companies could not be

profitable if they followed these guidelines. The interviewees felt that China is pricing itself out of the competition or “*sawing their own branch*” as it was said. When you wish to employ trained people, they have priced themselves relatively high even when comparing to the wages in Finland but when you wish to employ the best people you have no choice but to pay.

The literature and past studies on Finnish firms operating in China had noted that the Chinese business environment is highly bureaucratic as government officials often have overlapping positions causing the need for firms to go through multiple people before finding the right answer (Kosonen 2011). When asked about China’s level of bureaucracy all of the interviewees responded China to be highly bureaucratic except for Mr. Närvä, who found that as he is on the other end of the supply chain he did not have to deal with bureaucracy but said that for the sales people, bureaucracy is definitely high in China. It was said that you need to spend a lot of time and have the patience to sit and talk for hours and on multiple occasions. Mr. Sandås said that in his experience you have the same conversation with different parties 15 times and then you might be able to get some sort of an answer. Mr. Rajamäki from Vacon reported that over 30 percent of his time went into dealing with different governmental parties and “*holding their hand*” as he put it. The interviewees also wondered that if they face bureaucracy like this then how can regular people function in China. Still many noted that there is a difference if you are dealing with a state owned enterprise or a private firm and on the project. Private firms were said to resemble more the European style of doing whereas with the SOE’s the process was much more bureaucratic. Then to get things done and approved and moving, you needed multiple dinners and multiple discussions with different people. Often you would have different meetings so that every time, a slightly more influential person in the hierarchy would come and ask some more questions and after you have gone through several rounds of meeting you can finally reach the so called big boss who then has the ability and authority to make a decision. So firms have to be able and willing to spend a lot of time consulting and discussing with different government parties and be prepared that in a government organization you move from one level to the next very slowly before any permits or decisions can be gained. It is important to note that the government wishes to be very involved in the actions of foreign firms so a lot of the managers’ time can go to managing different government parties.

But it was highlighted by all interviewees that once you have managed to get the deal everything starts moving very quickly. Especially when the project is of great importance to China then it was said that it goes forwards “*like a train*”. In Mr. Vuollet’s

experience it can first seem like you are getting nowhere but in the end things really start to happen and all of the sudden you can find 300 strangers on your factory's building site fixing everything up. So the literature was supported on the high bureaucracy that causes delays on projects and firm actions and also forces foreign firms and especially their managers to spend a lot of time with multiple parties before they can take action. Also they require a lot of time spent outside of the office in lunches or dinners as well as money but once things start moving they move on with speed and there is no stopping them. To overcome the high bureaucracy it was said that you need to know the right people from high enough and then all the permits and everything else is sorted. Otherwise you will end up having to go up one level at a time before you reach the top of the decision making and the hierarchy. So relationships are clearly used as a way to overcome the high bureaucracy in the Chinese market.

IPR is clearly an issue in the Chinese market. All firms reported having issues with IPR in one way or another and having to constantly monitor the market and very carefully consider what information give to China. Mr. Närvä found that the Chinese are very good at copying, it seems to be part of their nature and they feel that they are not doing anything wrong. To him it sometimes felt that they do not really understand that someone can have patents behind a product and what that then means. Mr. Vuollet had seen straight copies of some of their products made by their subcontractors. Also Mr. Rajamäki said that they constantly see products that look like Vacon's products. Vacon once found a brand that had products that from the outside looked exactly like their products and also the firm had the same kind of websites as Vacon did.

Still when discussing the IPR situation in China all of the managers said that they did not see it to be as big of an issue as it has been made to be. Many of them commented that even as China is the king of copying and children are taught to copy from early on, they felt that the country lacks the ability to innovate and truly understand how things work. The pieces copied often are exact replicas on the outside but they do not have the quality and the functions that the originals have. That was the case with Vacon when they took apart the copy made by the brand that even had similar web pages, they found that the technology was nowhere near Vacon's solutions. All of the managers felt that the Chinese so far have not been able to make one-to-one copies of their products and have not been able to figure out the software and technology of the products. It was said that the Chinese are very skilled at copying and doing things by the book but they do not have the creativity and the ability to think outside of the box so that great innova-



tions could happen or so that they could figure out the technology behind the products and understand how it works.

*“I have heard and read the studies claiming that the main part of Finnish firms see the IPR environment in China as a big challenge but then when you ask them how many of them have actually been harmed by it or had any problems with this thing or have had some sort of misconduct related to it I think that the percentage will drop quite drastically.—I know that there are certain things that have been copied and maybe it has been more in the past.” (Mäkinen 2014.)*

All of the interviewees said that the risk is always there no matter where you go so you need to protect yourself and have your patents and your contracts in order and if you carefully consider what is the information that you give out you should be alright. According to Mr. Sandås, IPR is a problem as long as the firm makes it a problem. Where as they did not feel that the IPR legislation or the copying in itself was such a big of a problem as predicted by the literature, that it is a normal risk that you have in business, it came apparent that they do need to monitor the market more than they do in other countries just to make sure that their products or components are not copied. All of the interviewees noted that it is very important to beforehand carefully consider your partners and subcontractors and the information that you give there and after you have given the information you monitor the market to see if the information is spreading there. It is a part of the firm’s strategy discussion to decide on the amount and quality of the information they give out in China. All of the firms carefully consider what is the information that they give out and often the information is spread out to different people in the organization so that no one person gains access to all of the information. Firms have had to strictly define what is the information that can be given to for example to subcontractors, which is very different from Finland where confidential information is automatically considered to be confidential but to the interviewees it sometimes seemed that in China people do not seem to understand the concept of confidential information. In Mr. Vuollet’s opinion you need to be really aware of the information that you give out to China as things have a tendency of not staying as a secret even when they are meant to.

This is something that you need to keep in mind and realize if you wish to do business in China, especially today when firms are increasingly expected to have R&D operations in China, not just manufacturing. The issues with IPR clearly show that the institu-

tional environment affects the strategic decisions that firms make in the Chinese market. Still it was pointed out that the firms will sell to China if they have a customer willing to buy. When you have a customer interested, you do not stop and consider if you can sell it in case the customer might copy it unless you want to lose the deal.

*“If we are afraid and refuse to sell there because you feel that they will anyway copy my product then you can, like for example in our case, lose millions of Euros worth of sales just for that. So if you are afraid of the IPR then you should make a strategic decision of not going into China.”*

(Mäkinen 2014.)

It came apparent that the monitoring and the punishments regarding IPR are very weak even as the government has tried to improve the situation. Mr. Sandås felt that a court in China is no use as in his opinion you have already lost your business as it has already been copied, spread and used even if you manage to win the court case. So the trust towards the Chinese court system amongst Finnish firms was very minimal and they felt that even if you get to court then the Chinese counterpart often is not punished or the punishment is not really followed through so they can continue violating your IPR rights. It was said that you have to yourself confront the misbehaviors. So taken from the interviews it appear that IPR is not such an issue in regards of the copying and piracy, that is seen more as a regular risk of doing business but IPR violations are still a factor that affects the firm performance with the excess costs from the need to monitor the market and the information you give out more closely, not being able to give out all of the information necessary and ending up manufacturing in Finland.

When it came to the government incentives the responses were mixed. The Switch noted that there are government incentives for foreign firms but since their operations in China for the first few years had been very unsuccessful they had not been able to benefit from them. Mr. Mäkinen from Vaisala noted that since the company had entered into China much prior to his time at the company or in the operations in China he did not know if any incentives had been received but felt that no incentives had been received recently. He noted that of course their financial department will of course try to optimize all taxes but in his opinion the business needs to be profitable without any incentives, especially as Vaisala has been in China for almost two decades now. Wärtsilä and Vacon on the other hand had benefitted and taken advantage of the different incentives offered in the Chinese market to attract foreign firms. Vacon had managed to gain a status as a high tech company by proving that they have production and R&D in China and

gain tax reliefs from 5 to 10 percent. They noted that it depends on the company and the industry the company operates in and the technology it brings on how interested the government is in it and this is shown by giving the company an x number of tax-free years. Or the local government can also give you a certain sum of money. China has invested in different development areas which are trying to attract foreign firms and bring them in to boost the local economy and business. It was noted by Mr. Mäkinen that with this new Five-year plan the political atmosphere is developing towards a more favorable environment for cleantech firms as the government aims to improve the welfare of its citizens and the quality of the air. This creates a positive environment for sustainable growth in China and also for companies that can with their technology and products help this development. Cleantech as an industry is very high tech and, as seen in the new five-year plan, a clear focus point of China's economic development so China is clearly very interested in attracting new cleantech firms as demonstrated by Vacon. So foreign firms have a possibility to benefit in the form of government incentives if they so wish and have products that interest China. They also have some power over the areas in which they operate in. As the local governments want to keep foreign firms in their area they cannot drop the incentives too much or have too high demands as then foreign firms can leave and head off to another area where the benefits are better. It is important to note that these incentives are highly tied to having production and bringing in R&D into China as the country is looking for ways to improve their level of technology. That can explain why Mr. Mäkinen did not feel that they had received any incentives as Vaisala is the only company from the interviewees that does not have a factory in China. So government incentives can really help a foreign firm but this often requires heavy investments from the firm's side as well.

The level of regulation got mixed responses as well from the interviewees. Whereas Mr. Mäkinen, Mr. Närvä and Mr. Vuollet felt that the regulations governing foreign firms and the requirements of permits and certificates were relatively same as in other countries, Mr. Rajamäki and Mr. Sandås had noted that the regulations are often stricter for foreigners than they are for domestic firms. In Mr. Närvä's experience, the regulations regarding the basic business and day-to-day operations are relatively the same as in other countries but when first establishing a business, the environment can be highly regulated. Mr. Rajamäki noted that Vacon had, when establishing their factory in Suzhou, faced several changes in the laws and felt that the legal requirements regarding their factory were far more extravagant than on the Chinese firms across the road. They had for example right in the middle of the construction received a letter saying that the regulations have changed and all firms are now required to have an emergency generator

and a fully functional sprinkler system in the factory. So Vacon was forced to build a separate generator and a tank to contain the water for the sprinklers and Mr. Rajamäki said all of this cost them hundreds of thousands of dollars and felt that:

*“I cannot believe that the hundreds and thousands Chinese factories were on the same level as us and had to make such huge investments like us. – I can honestly say that it (the law) is different for westerners and locals and on the other hand the how the locals stretch the law and regulations, it is definitely money that speaks there or then it is guanxi when the officials change their focus elsewhere”. (Rajamäki 2014.)*

Whereas the interviewees felt that China is more strictly regulated than Finland they also said that the regulative environment is in a way more straightforward than in Finland. Decisions go through in a much quicker pace and things start to move much more quickly. Even as foreign firms have different requirements, when doing business and making things happen the Chinese government was said to be much more dynamic than the Finnish government.

*“In Finland you can completely stop a construction site if you find the droppings of a flying squirrel but in China that’s not the case. Even if you need to get more permits everything can still be decided and dealt with remarkably faster than here in Finland. Once things start rolling it goes straight to the finish line without stopping.” (Vuollet 2014.)*

Mr. Sandås and Mr. Närvä though that this could be because of China’s one party system. It was said that if China had Finnish democracy they could not manage to act as quickly as they do and make the quick changes. China has risen to a global economic giant in a short period of time and perhaps the one party policy has made them able to move forward quickly and make decisions that then take the country to a direction of development. China has the resources and the money, the ability to make quick changes and the projects are then implemented in a larger scale and faster than in Finland.

#### 6.2.2. Legal institutions

All companies recognized that there are issues in the legal environment of China. It was said that the situation has improved slightly over the years. Whereas before there were no regulations and guidelines in some industries all firms were able to do almost what-

ever they wanted and offer products that in the end could not be used. Mr. Närvä had seen this in the wind power industry where still in 2010 the requirements for the products were so non-existent that a majority of the products offered could not produce energy. As the government has realized this problem they have clearly started to redefine the requirements and legislations. It became apparent that the implementation of the laws is very weak and the interviewees felt that this was due to the quick changes and the vagueness on how laws should be implemented in the business environment. Even the government officials do not necessarily know how the laws should be implemented sometimes.

The quickly changing laws and regulations create strain for companies to monitor them and desperately try and keep up with the changes and adapt their actions accordingly. Mr. Rajamäki also felt that the people in China, the individuals are no longer law abiding, especially in the younger generations where the hierarchy and the “*fear of the lord*” is slowly subsiding. According to his experiences, the atmosphere in China is towards “this things was not specifically forbidden so that means that it is allowed” type of thinking. He felt that it was so that the Chinese people do not necessarily have a clear understanding of what is right and what is wrong. Due to the fact there is around 1,4 milliard people in China it was thought that it can be nearly impossible for the government and the legislative organizations to really govern the people and see that the implementation of the laws are followed through.

Mr. Vuollet also said that it is important to remember that the law is not the same for everyone in China and in his opinion it highly depends on the situation when the law is on the side of the Chinese party and when it is on the Western party. Also it came apparent in the interviews that even as the laws are in place I was felt that people mainly do not respect the law. Mr. Sandås felt that even as China is more heavily regulated than Finland, the message from the market is that there always is an option of not following the law. Mr. Närvä commented that in his experience, the Chinese traditionally interpret the law to their benefit. All firms felt that there are a lot of laws in the Chinese market and some remarked that there are specific laws placed on foreign firms. It was felt that this was done to make it more difficult for foreign firms to succeed in certain things and to promote the Chinese equivalent. So it was clear that all of the interviewees felt that the legal environment cannot be trusted in the same way as it is done in Finland and that one of the main issue is the lack of respect towards the law in all parts of the society. Even as this is the case in the Chinese market, as a foreign company, you have to re-

spect the laws and regulations, you cannot take the risks so you always function according to of the laws to your best ability.

*“Only a few rely on the legislation there in the same way they do in Finland. – It is very clear that the respect towards laws and regulations is not at the same level as it is in Finland or in any other country.” (Mäkinen 2014.)*

The legal environment in China is very turbulent according to the interviews and it was agreed by all that the laws do change there very quickly. Mr. Sandås had had experiences where he had been informed that the law had changed and that it had changed yesterday.

*“They said that it changed yesterday and now everyone needs to start following the new law immediately or you should have followed it already from yesterday, even when you did not know it had changed”. (Sandås 2014.)*

Mr. Närvä had noted that the laws can change in a day and are applicable until the next change that can happen the day after. Also Mr. Rajamäki said that he had received notifications saying that now a new law has been put to place and it will come into force within a month's time. When Vacon was building a factory and had signed the lease and made all the contracts and opened the factory, they received a letter stating that the use of the area had be redesigned and the factory would be partially torn down. Vacon was able to negotiate with the local government and was able to keep their factory untouched but saw many neighboring firms being torn down due to the new and changed plans. Clearly the legislative decisions and situations can change in a heartbeat. So the changes in the legal environment are rapid in the Chinese market and happen constantly. When asked did the firms feel that these changes are well informed they all disagreed. All of them said that yes the changes are informed eventually but usually so that the new regulation comes into effect either immediately or the most in a month and you are then informed by a letter that is in Chinese. So none of the companies had any idea of the regulation drafting process and felt the government pushes out new regulations almost as fast as they can and does not inform anyone about it.

Mr. Mäkinen regarded that the legal environment suffers from a lack of transparency between the organizations operating in the Chinese market and the parties drafting the

regulations. It was said that if you are willing to invest heavily into people that will go to the government and lobby for you, then you might be able to influence the decision and law making in some way. Also having influential customers was said to be one way to try and lobby yourself. As the legal environment is full of constant changes this often means that the implementation is weak. It is often unclear for the local government and their officers on how the new laws should be implemented and this gives firm extra time to implement the changes required by the new laws. Mr. Vuollet regarded a case where a new regulation came requiring them to start making social security payments but as it was so unclear for them and the local government how it should be collected that they got extra time to organize things and in the end the payment was not collected at all.

In the discussion regarding the local courts tendency to favor local firms, the interviewees felt that this depends on the situation and on the court but that the courts clearly do have a tendency to favor local parties against foreigners and there is always the question of possible corruption. All of the firms interviewed did not see courts as an effective way to solve disputes in the Chinese market and preferred not to use them. It also came apparent that the Chinese counterparties also prefer to not involve the police or go to court due to the weakness of the law and not knowing which way the case will go. That is why the firms interviewed prefer to handle their disputes and possible IPR violations straight with the violator through negotiations. Firms also prefer not to go to court because the procedure is extremely slow. So when violations happen, firm said that they most often cannot rely on the law or the court as depending on the case and situation they end up favoring the local player so it much more effective to personally contact the violators and set up meetings with them and get them to stop.

The main way the companies interviewed protect themselves from the vagueness of the law and the lack of implementation was to have connections. All firms have many government factories and players as their key customers so they have the ability to try and influence to legal environment through them. Mr. Vuollet noted that if a regulation comes that is bad for their operations there they have their customers, government owned customers, who will then go and lobby for them so that the situation can be changed. So the informal relations that you are able to create will help to overcome the obstacles of the constantly changing, vague and under implemented legal environment and possibly even be able to have a say in the laws and regulations. So it was clear that all of the obstacles found through literature in the legal environment are still relevant in the Chinese market and the improvement has not been as fast as firms would like. Firms are left with a very complicated and inefficient environment in where you cannot rely

on anything expect yourself and try your best to keep up with the changes and protect yourself.

### 6.2.3. Information institutions

When discussing the situation of the information institutions in China, the interviewees felt that it is easier to find information about the market itself but it is more difficult to get valid information concerning other businesses and potential partners. Today there are many large global institutions that monitor the market and gather information regarding it so firms said that that is not an issue for them. The main issue is that it can be a very long and difficult process of finding out truthful information from potential business partners, customers and suppliers. Mr. Mäkinen had noted that everyone in the market wishes to keep their own business as a secret so nobody necessarily knows what the other is doing. The interviewees noted that the Chinese firms have a tendency to exaggerate their profits to make them seem more attractive. They said that it is a part of the culture to offer a very limited amount of information first hand and try and give the best possible impression of themselves. Some had noted that people living in worn down houses would come out wearing a designer suit as the outside appearance is highly important to the Chinese.

*“You need to know straight away that what they show to you is not true and you have to dig the truth out some other way. We always knew that whatever figure they give you, take half of it off and then you might be closer to reality”. (Vuollet 2014.)*

Vacon relies on their local organization to get information from the market and report what they see there. If there is something that alerts the interest, then Mr. Närvä himself goes to visit the site to see what it really is. You cannot use Google to find anything about anyone like you can in Finland where firms and their actions can be easily verified from their internet sites. When beginning the negotiations with a potential supplier, business partner or distributor you need to use your common sense, do some counting of your own, visit the place to see what it looks like and ask and then ask some more and then it was said that the truth will slowly start to come out. Mr. Rajamäki said that he had created a tier 1-2-3 method as he called it to help his staff to find out if a partner is a potential one or not. The method consisted of questions regarding the company's revenue, profits, the office itself, the number of sales people and their origins and after sales marketing to make sure that every aspect is covered and hopefully somewhere in



the process the faults and lies are caught. He said it is a long and rocky road to try and find out from potential partners that what is true and what is not and you need to be patient, persistent and take your time.

*“On the level of individual firms it is a line drawn in water on how much of what they tell you is bullshit and you need to understand the environment and the mechanisms to see if it can be true with this amount of personnel in this kind of office with this amount of clients” (Rajamäki 2014).*

Many firms heavily rely on their trustworthy connections from who you can gain recommendation about a good partner and also find out information. It was also recommended that you need local employees to help you monitor the market. A good example of the lack of information in the market about partners and their actions came from The Switch.

*“When we did the lease for our first factory space, we made the deal, signed it and then they started demanding a down payment from us. Then we had a huge discussion about if we are going to pay or not and I told them we are not going to pay. Then two months after there comes another guy who asked us what is going on, that this is his factory and how can we lease it from someone else. So that shows how hard it can be to get truthful information and there are many people in the market who try to benefit from this fact”.* (Sandås 2014.)

The findings taken from these interviews are gathered to Table 7 to illustrate both the negative and positive factors in the formal institutional environment of China.

**Table 7.** The factors of the formal institutions gathered from the interviews**Factors negatively affecting case companies performance:**

- Government restrictions on ownership and pressure to form JVs & customs duties
- Government highly involved in the establishment of operations
- Increased protectionism in the Chinese market -> need to manufacture & bring R&D to compete in the market
- Heavily regulated market, especially when building a factory and establishing initial operations
- High bureaucracy - time and money needed to gain access to the decision makers
- Constant violations of IPR rights - copying and information is easily spread
- Incentives require heavy investments into China – production & R&D
- Unclear legal environment - weak implementation of the laws, confusion on how implementation should be done
- A clear lack of respect towards the law in the market
- Quick and drastic changes in the legal environment that are poorly informed
- A clear tendency to favor local companies in the legislation and courts - need to solve the disputes yourself through negotiations
- The slowness of courts
- Lack of information on local firms & local firms tendency to exaggerate and hide information- increase partner related risks and increased monitoring and resources need to be allocated in the partner choosing stage to avoid costly mistakes

**Factors positively affecting case companies performance:**

- The governments increased interest in Cleantech
- The speed of government execution once regulations and contracts have been set
- Regulations regarding day-to-day operations relatively the same as in Western countries
- Government incentives such as tax reliefs and funding especially towards high-tech
- Weak implementation - gives firms time to act or disregard the new law as no one knows how it should be implemented and in what time frame
- Market institutions gathering market information

### 6.3. Impacts of the informal institutions

In the literature review it became apparent that some researchers feel that in the beginning and during the transition of the institutional environment of the emerging markets, firms rely heavily on relationships and networks but as the institutional environment changes and becomes more stable, and the formal institutions become stronger the need for these networks will diminish. (Peng 2003: 281-282.) The informal institutions impact foreign firms greatly through cultural differences, local partner and business networks and corruption. When analyzing Finland and China together on Hofstede's dimensions it shows that the two countries are culturally very distant from each other, which can create strains in the management, communication and negotiation process. Firms need to pay attention to these cultural differences in order to do business in China. As the formal institutions are regarded as insufficient and underdeveloped in the Chinese market, informal institutions and relationships are often regarded as the answer to these issues. The relationships that you are able to formulate in the market and the networks you can gain access into facilitate a foreign firm's operations tremendously in the market as they can help the firm gain resources and information. But this high emphasis on relationships and the need to create trusted relationships with the Chinese counterparties in order to do business can also negatively affect a firm if it does not manage to formulate these connections. The relationship formulation process is slow and requires a lot of time and money but when a trusted relationship is made, the business will be fruitful. Corruption is very eminent in the Chinese market and it is heavily linked to the Chinese history, relationships and culture. As informal institutions are often invisible to foreigners corruption can also be very hard to spot in the market and it can be hard to fully protect yourself from it.

#### 6.3.1. National culture

When the interviewees were asked if they felt that Finland and China were culturally distant the answer given was mainly "*well, yes and no*". The interviewees found there to be high differences in the communication style and way it is conducted, the hierarchy in the business environment and a high language barrier. All of the interviewees regarded that the Chinese business culture is very highly hierarchical. It came apparent in the negotiation and business meetings as the final word can only be given by the boss, so often in the beginning of the negotiations the people present refrain from giving any answer as it can end up being contradictory to what the big manager has to say. Also many rounds of negotiations have to be done before you are able to gain access to the manag-

ers. The Chinese workers that they had in their companies were said to be afraid to take initiatives or responsibility and they always seem wait for the commands to come from above. Of course there are exceptions and people eager to take on responsibilities. Mr. Rajamäki referred to this as the *“fear of the lord”*. The employees are often afraid to give any criticism or question their orders, the organization is very important to them and the decisions are made by the most senior person. All managers felt that most of the Chinese subordinates need and want to be given orders. It was noted that there are clear differences in this between generations. Whereas the older generation is very formal and respecting of authority, the younger generations are starting to become increasingly more relaxed and also more demanding in regards of jobs, they want to know what the company will give them and not what they can give to the company.

Mr. Rajamäki also commented on the high respect for hierarchy in the Chinese culture. He felt that as he already had some graying hair he was regarded as a more serious candidate to do business with and he was also more easily respected by the business people and officials. He told that he also used this respect for authority and hierarchy as an advantage. During his time in China he started to bring a photographer with him to all meetings and greetings and then ask to take a photo with the people he met. This way, every time a new government official would come and visit his office he would first point the attention towards the photos. He said that you could instantly see how the atmosphere changed as the people realized that he knew some very influential people both in business and in the local government.

All managers also felt that in China there is a certain type of a “code of silence” as they referred to it. They said that it was very difficult to get anything negative out from the Chinese parties or workers. If something was wrong or done wrong nobody spoke about it unlike in Finland where problems and issues are easily voiced out and if someone is behaving irresponsibly it is told. But in China even if it was their job on the line the code of silence seems to stick and no issues or problems were voiced. The interviewees felt that you have to really dig deep as a manager to find out what could be wrong and because the problems and issues are not voiced out amongst the workers you sometimes have to make decisions on a very limited knowledge. They said that it can take a really long time to be able to build that type of a trust with your subordinates that they feel that they can talk to you openly. Mr. Vuollet said that it took him almost two year before people were able to talk to him freely and tell about the possible mistakes that had happened. All of the firms try to encourage their workers in voicing out issues they

might have but it was said to be a very lengthy process and even after many years only a few will open their mouth and speak up.

The interviewees had also noted a clear difference in the way thinking and communicating. Mr. Mäkinen said that in Finland people are very systematic and things are clearly organized and listed into different to-do lists but in China, in his experience, the conversation goes from one thing to another randomly, the thought process is not straight forward but more changing direction constantly going back and forth in the different issues. So it is sometimes very hard for a foreigner to follow and it can seem very irrational. Where as in Finland once you have drawn out the guidelines you pursue straight on with the execution and only if you see a fault is the plan changed. In Mr. Mäkinen's experience in China the things you have agreed on change constantly, new things are added all the time and if you agree on something today, it might not be the situation tomorrow. This can be very frustrating to both parties and create frictions in business negotiations and in different teams. The cultural differences noted went sometimes in the interviews onto a very personal level. Mr. Vuollet had found the Chinese habit of not queuing very rude and disturbing where as Mr. Närvä had found it very difficult to make friends with purely Chinese people as the interests in life were so very different from each other so it was very hard to engage in a discussion with them. There are multiple small differences that make the cultures very different especially in the day-to-day life but in business it was said that the culture of doing business is relatively similar throughout the world.

All of the interviewees said that the majority of Chinese do not speak English either at all or very poorly. This is an issue in dealing with both customers and suppliers in the market and also very often when doing business with government owned institutions where the business environment is often very old fashioned and conservative and where English is not seen as a necessity. Therefore when doing business with Chinese parties you have to have local employees so you can operate and do business in the market. It was regarded that this often is a clear extra cost, as the people that can speak English are a rarity in China and are often highly educated and know their value in the market. Mr. Närvä noted that the situation is improving slowly, at least in the electronics market where the majority of sellers and buyers are highly educated engineers so the situation will hopefully continue to improve in other industries as well.

As an aspect of the culture what was brought out was the Chinese tendency to dine. It was said that always when the interviewees were visiting China there were already mul-

tiple parties expecting them to dine with them and they found it surprising how important food and dining seems to be to the Chinese. In Finland people often prefer to do other things amongst dining such as playing golf as it was suggested so this tendency and the necessity to always dine before getting into the business and the purpose of the meeting was sometimes found a bit exhausting, as the interviewees sometimes would have just preferred to go straight to the point and have the meeting over quickly.

### 6.3.2. The importance of relationships and networks

One of the key differences in doing business in China and doing business in Finland is the relationships and the need to create a trusted relationship before you can do business. Mr. Mäkinen summarized the difference well: in Finland and in the western world it is very common that you never even see or talk to your customer. They order the products they need online or by contacting a sales representative by email or phone who then draws out the offer. After the customer has received the offer and accepted it the deal is done and no physical face-to-face meeting is necessary. The customer analyses the product before hand, decides if it is what they need and they are also willing to take some responsibility that the order they decide on will fit their needs. If not, then it is a risk they have knowingly taken and accepted. Where as in China all the interviewees emphasized that the Chinese first need to build a trusted relationship before they can start doing business with you and they are often very particular about getting a guarantees on service and possible repairs if they should need them. This trust is the main reason that requires you to dine with them and the company needs to be actively present in the Chinese market to show their presence and to be able to provide local service. After the trust between the parties has been created this then provides the business relationships with continuity. Mr. Mäkinen had found in his field that after the trusted relationship has been created, the price becomes secondary where as in Finland the emphasis always remains on the price. It is very important to note that if you lose the trust it might never be regained.

When discussing the relationships that the firms make, all of the firms felt that having the business to business relationships in the Chinese market is mainly more important than business to government relationships. Vaisala and Wärtsilä noted that due to their products, their main customers are government organizations or are government owned so automatically when they formulate the business to business relationships with these clients they are through them formulating government relationships as well. The Switch and Vacon also noted that mainly their relationships with the government or the local

government are through their business relationships with partners and clients. All of them though that it is very important to know someone in the local government or know someone who knows someone but when doing business, the emphasis in formulating relationships in China in all companies was more on business to business relationships. Vacon was the only firm that felt that government relationships play a critical role in China. It is the government and the local government that you have to negotiate with in regards of the location of your factory and also in many other things such as staffing and their wellbeing. It is critical to make connections with the local people and especially with the decision makers. Mr. Rajamäki said that in his opinion the three years he spent in China going around and meeting people was not nearly enough. Vacon is still a relatively small firm where as he said that large multinational firms have people specifically to lobby their firm in the local and central government. The need to make connections with the government differs highly from the business environment in Finland. All of the interviewees said that in Finland none of them have personal relationships with politicians and most of them have never even met any. But in China you do meet a lot of government people on various different occasions and often have to create various types of relationships with them just to make sure you can do business and that when you do, it runs smoothly.

Many of them also regarded that the government officials often have a tendency to use the power that they have on foreign firms. This is visible in their behavior as they expect the managers of foreign firms to always have time and be available for their visits. Often these visits are announced an hour before and the managers reported that then you had no other choice but to quickly clear your schedule as you could not suggest another date or time. If the government officials decided that they had time now then you also had to have time now. One of the interviewees reported a case when his colleague had been leaving for a holiday in Dubai but had been called to be in China right in the middle of this holiday. He had had no other choice but to come back to China through the holiday for a two-hour meeting and then fly back to Dubai to enjoy the rest of his holiday. Where as a western firm functions in a very organized, planned way with calendars full, the Chinese behave in a more impromptu manner and this reflects in the ad hoc nature of the government and the government decisions as said by Mr. Rajamäki.

The business networks and especially the old guanxi connections were said to be very closed in China. Mr. Sandås regarded that these types of networks can be so tight that as a foreigner you have a very slim chance of getting really into these networks. Mr. Vuollet had also noted, to his surprise, how important for example classmates are in the

Chinese business environment. He had found that people who graduate from the same school continue to link closely with each other in all parts of business and always aim to help each other out and clearly prefer to do business amongst each other. Also there are clear in-groups that you cannot reach as a foreigner like the communist party. Members are often promoted into government jobs just on the basis of belonging to the party and not on the basis of their capabilities. Mr. Mäkinen had also felt that there is often a sort of unspoken regulations and understandings of who you can do business with. The customers have a certain person through whom they wish to conduct business and that is a part of the Chinese way of doing business. This again can reflect back to the *guanxi* networks that are often invisible for foreigners. Relationships and people that you know are highly important as without them you might not be able to do business at all. The customers might not want to even talk to you since you are a foreign operator so you need to have local people there who have the connections.

Still it is crucial to carefully consider the local people that you hire. Many people in China use *guanxi* and their *guanxi* connections as a reference in their job applications. Still it is important to try and find out the level of the *guanxi* connections that the employees claim to have. Mr. Rajamäki noted this when he had sales people that were boasting with their *guanxi* connections. He then wanted to know what was this “*guanxi*” all about. As he was explained the basis of *guanxi* he asked his sales people who their biggest client is, who the chairman of this company is and whether or not they know him so well personally that they know when his birthday is. When nobody was able to tell him when the birthday was he said that he had pulled out his cell phone and showed them the invitation he had received for the upcoming party. So it was apparent to him that if this was *guanxi*, then he has managed it better with their customer than any of his sales people who are constantly referring to *guanxi*. Mr. Rajamäki had also found that *guanxi* was often used as an explanation when a sale did not go through. He often heard that the reason was that the sales person did not know the person he was selling to and as they did not have a *guanxi* network he was not able to seal the deal, which Mr. Rajamäki found strange as in Finland trade is done without needing any sorts of close relationships with the buyer.

In order to create these trusted relationships all interviewees reported that you really need to spend time and money to make it happen. You need to be willing to wine and dine, sit down and eat with them and drink with them. It was said that food and having a dinner is considered to be very important in China. The experiences regarding these dinner occasions varied. Whereas Mr. Vuollet said that in his experience a Chinese



dinner, where you meet and start building the relationship, always lasted for two hours and no more. After that everyone leaves. Mr. Rajamäki on the other told that he had once had to enter into a drinking competition after a dinner. He had met with the local government officials and when he had managed to outdrink the Chinese party everyone had been very pleased and the contracts had been signed the next day. He felt that he was regarded as the “*big chief*” that can drink with them. He felt that the atmosphere was very similar to Russia when he had been doing business there years before. The main message from all of the interviews was that you need to be prepared to spend a lot of time and resources to sitting at dinners as the relationships and especially the mutual trust is created in these dinners. The trust in the relationship is constantly tested through business transactions and these dinners to see if you deliver what you have promised.

As in the discussion on the formal institutions it came apparent that relationships and the people you know in the market are critical in helping firms overcome obstacles and difficulties in the formal environment. When asked about the things that have improved the firm’s ability to function in the Chinese market and what has been the key to success all firms said that it has been due to the relationships they have managed to formulate in the market so the importance of relationships is very high in the Chinese market and in order to succeed you need to create good, trusted and long-lasting relationships.

### 6.3.3. Corruption

All of the interviewees agreed that corruption does exist in the Chinese market but due to its hidden nature it was said that it is virtually impossible for a foreign firm to see it and really evaluate what the level of corruption is in the market. All of the interviewees strongly denied that the firms have anything to do with corruption and all of them have strict guidelines and codes of conduct on how corruption must be handled and reported if it is spotted. As the firms are strongly against corruption and do not take part in corrupt activities in any way they could not know the level of corruption in China and where it exists. It was reported that they felt that the Chinese people deliberately aim to hide corrupting from Western people.

*“They know that the Western people would take action and interfere so they keep it (corruption) to themselves. So that makes it invisible for us but we know and we have a hunch when it might be happening, we are not stupid, and then we take action”.* (Vuollet 2014.)

The interviewees felt that corruption is very much embedded into the Chinese culture and in everyday life so it is regarded as normal in the Chinese society. It was noted that the involvement in corruption starts from early on, even in schools you need to bribe the teacher to make sure your child is seated at the front of the class so he or she is able to learn. Corruption is very linked to the connections that a person needs to have to make it in everyday life.

The firms train their staff and also their suppliers and their partner firms on corruption but of course they admitted that it can be hard to really monitor the suppliers and partners if these guidelines are implemented in action in their value-chain. They told that the best thing you can do is just keep away from it and the only solution is that you do not participate in corruption in any way. When doing deals you have to really dig deep to find the truth to make sure your business deals are clean.

*“You just do not get involved in it (corruption). There was once a firm in our field of business that got involved in corruption and now they can never again enter into the Chinese market as their access is strictly forbidden and the Chinese firm that was involved no longer exists. So you do not go along with corruption”.* (Sandås 2014.)

The penalties for corruption are strict in China and the interviewees felt that the atmosphere towards corruption is increasingly becoming more negative. Mr. Mäkinen had noted the increased government actions against corruption and had felt that there are increasingly stricter guidelines on the actions of government officials to help fight corruption. Mr. Vuollet felt that the increases in wages are a factor that can also help fight corruption, as there is less of a need to make money on the side. All of them said that mostly corruption exists in the local business done with locals. Corruption is very difficult to spot and very hidden and it is very challenging for a foreign operator to truly understand where corruption is happening. Mr. Närvä said that he had talked and interviewed a lot of local people to better understand corruption and to hopefully gain some understanding on how it is actually done and how it actually works but still he found it difficult to fully understand it.

Unlike predicted, the Finnish firms interviewed did not see corruption as a major problem in the Chinese market but more as a normal risk of doing business there like in many other countries. Corruption reports often take into account the views of the local businesses so this can explain why Finnish firms did not feel that corruption is as big a

problem as it is made out to be. Also it might be due to the fact that corruption is so hidden that the firms have no clear understanding of the depth of corruption in the market. Even as corruption is very hidden and exists mainly amongst Chinese people and their everyday life and business, it is still a clear threat to foreign firms there. Firms need to try and monitor the situations in order to avoid corruption. Even as the situation in the Chinese market is improving and the government is clearly taking actions to improve the situation corruption is still a big factor in the Chinese market.

Table 8 gathers together the different factors gathered from the interviews in the informal institutional environment.

**Table 8.** The factors of the informal institutions gathered from interviews

**Factors negatively affecting case companies performance:**

- Differences in communication and language barriers
- Corruption - creating the need to monitor the market & your network
- “Code of Silence” in the environment – negative information is not shared
- The long and expensive road to create the trusted relationships – need to wine and dine and be actively present in the market.
- Closed guanxi networks that are hard to access and the use of guanxi as an excuse in failed sales

**Factors positively affecting case companies performance:**

- Relationships – both business to business and with the government help gain access to resources and overcome issues in the formal institutional environment
- Creating trust and long-term commitments

#### 6.3.4. Other issues that rose from the interviews

As China is a huge country with different regions very distinct from each other and where over 80 different dialects are spoken, it was also discussed whether or not these differences had been noted. When asked if the interviewees felt that there were local differences all of them replied that yes, there are some local differences in China when you go from one region to another, but none of them felt that these differences were big enough to need any special actions or changes in actions. Some of the interviewees re-

ferred to the differences you have even in Finland between the people in the North and people in the South, they felt that mainly the differences were visible in the way that people behave, some regions are more formal and others more open. Mr. Vuollet regarded that he had been told by one of this employees that people in the north are considered amongst locals to be more trustworthy, as the traditional manufacturing industry is located there, and in the South are the easy money makers ready to take advantage of foreign firms. But none of them reported that these differences were an issue or that they had personally really noticed them. It was said that the differences might be more visible to the locals but as you are a foreigner everything looks relatively same wherever you go. Also when asked if the language was an issue as the dialect in various regions can be very different they all said that they would not know as they do business only in English and through the local people. This can be a reason why no major differences between regions were noted. Mr. Mäkinen noted that for Vaisala, in their business and industry all of the major decision-making organizations are located in Beijing so all of the regulations and such are concentrated into one place. He also commented that of course there can be regional variations in the regulations depending on the local government but so far Mr. Mäkinen had not noted any.

As all of the companies are operating mainly at the coastal area of China they lack the in-depth experience of China's other regions apart from a few customer visits. It was said that the coastal area has been one of the most FDI friendly areas in China therefore attracting firms. If they were to have more operations in other parts of China, they most likely would have more experience on the possible differences between China's different regions. All of the companies operate in a highly technological industry and the products do not need to be locally adapted. None of the companies had a regional strategy within China and none of them felt that there was a need to formulate one. So this study did not find that foreign firms operating in China see China's regional differences as an issue or even as something to really consider about when doing business. The issue might be different if the firms decide to move or begin operations in other regions. Then they would face the different regulative environments and most likely be forced to react to the local differences. As it has been discussed previously, even as the major political and regulative decisions come from Beijing, there are variations on how the local governments implement them. Many of the firms had noted that there is a trend arising where more and more businesses are shifting towards the center of China where there is a huge internal market growing. So in the future some of these firms might move their operations more towards the center of China but at the current moment all of them felt that their needs were fulfilled in the coastal region.

All of the interviewees felt that China's development over the past decade or so has been overwhelming. It was said that unless you have been there in 2007 and now, you cannot even begin to understand how huge the change has been. All of the managers noted that you could not believe that the market has started to really grow only since 2000 and today China is a global superpower and the home of some of the world's biggest markets. Still all managers commented on the lack of long-term continuity in China. The country operates on five-year plans and the interviewees felt that this is too narrow sighted for the country's economy, as they do not seem to consider what will come after the five years. Everything is done and executed with speed but sometimes it felt that there is a lack of coordination and communication between Beijing and the local governments. This puts strains on policy makers and government officials and also creates opportunism. The local governments follow their own plans and Beijing another so firms cannot rely on the fact that something has been implemented in Beijing. People know that they might not have a job anymore when the next five-year plan comes so meanwhile they try to benefit as much as they possibly can. It was noted that for a year before and almost a year after the new five-year plan comes into place people just wait and do nothing as they are unsure what this new plan is going to mean for them and how it is then supposed to be implemented. All of the managers felt that this was one of the main reasons holding China back from its potential as there is no innovation and no vision for the longer future.

The interviewees felt that in the next one or two generations China has all the potential to really become a global superpower. All of them felt that the atmosphere and the behavior as well as the business culture are increasingly becoming more "American". The old traditions of silence, corruption and guanxi networks were felt to become less dominant as the generations in business change. But they also felt that there can be a possibility that the development of China will seize due to the huge difference in income between people. The majority of the Chinese are still relatively poor and only a very small minority is actually rich. This gap in income has already caused several riots and for China's economy to continue to grow China needs to figure out a way to even out these differences. As the prices of housing and food are increasingly going up people cannot keep up with it. The issues with the environment were also named as one of China's big challenges. The drinking water in China is scarce as the water resources are so deeply polluted and Mr. Vuollet noted that in certain times of the year it can be almost impossible to breath due to the pollution in the air. All of these changes were said to require a drastic change in the culture itself and in the way people think and that is the major challenge for China.

In regards of culture many of the interviewees said that being Finnish has helped the tremendously to do business. This was said to be because of the image that the Chinese have about Finland and Finnish people. Finnish people over all are regarded as being very honest and hardworking and that is why they felt that the Chinese want to do business with Finnish companies. Also the image of Finland as a very clean country, green forests and clear blue skies has helped in the sales of the cleantech operation. Mr. Rajamäki said that he has systematically used the fact that the company is from Finland and has referred to the Finnish quality and to the Finnish nature and the cleanliness when doing business in China because in his experience it helps to sell the products. The summary of the main findings of this chapter and the interviews will be presented in the next chapter together with the main conclusions, managerial implications and the limitations of this study.

## 7. CONCLUSION AND DISCUSSION

In this chapter, the thesis will be summarized and the final conclusions of its findings will be presented. The research purpose and objectives will be reviewed and evaluated in the context of the findings. Furthermore, a few managerial implications will be proposed. Finally the limitations of the study will be discussed and some future research suggestions will be given.

### 7.1. Summary

The aim of this study was to establish an understanding of the institutional environment of the emerging market of China and evaluate the different formal and informal institutions in this environment and how they impact foreign firms operating in the market especially focusing on the cleantech industry. This was done by an extensive review on the existing literature concerning the institutional environment of the emerging markets and China in particular. For decades foreign firms have been increasingly interested in entering and operating in China, due to the countries low labor costs, huge market size and its growth rate as well as its increasing position as one of the world's superpowers. The emerging markets are quickly rising into the focus of the global markets with constant high economic growth rates and large domestic markets with wealthier customers. Still even as the opportunities in the emerging markets are huge, they still face the issue of their developing institutional environment. The institutional environment of the emerging markets is often described as being in turmoil as the countries are in the middle of trying to transform their institutional environment to resemble the western markets. This presents foreign firms with multiple obstacles, especially when the firms come from Western countries where the institutional environment is stable and institutions function so well that they are regarded as being invisible. For this reason it is important for foreign firms wishing to enter and operate in China to understand the differences in the institutional environment so they can be prepared to encounter these changes and adapt their strategy accordingly. Therefore firms need to take into account both the formal institutions meaning the political and legal environment and the informal institutions meaning the culture, norms and values that are strongly embedded into everyday life.

After an extensive literature review, a theoretical framework presented in chapter 4 was established. In the theoretical framework, the formal institutions were divided into three groups: the political and competition institutions, legal institutions and information institutions. It was found that the impacts of the formal institutions in China presented by previous literature were mainly negative such as government restrictions on foreign firms actions meaning limitations on ownership modes, IPR violations, high bureaucracy, weak implementation of laws, constant changes in the laws that are then not properly informed, tendency of courts to favor local player and malfunctioning information institutions that result in poor information transparency and increased partner related risks. The only factor to have a positive impact on foreign firms and their performance found in the literature was government incentives such as tax reliefs used to attract foreign investments. The impacts of the informal institutions were overall more positive as relationships are highly valued in China and they are in a critical role when doing business. Being able to formulate trusted relationships and gaining access to networks were regarded as being highly beneficial for foreign firms. On the other hand, firms coming from Western countries often face high cultural differences as well as issues with communication and language.

Also corruption is regarded as being very high in China so this again poses threats on foreign firms and their actions. After the framework was established, it was tested through interviews. The interviewees represent Finnish companies in the cleantech industry, both multinationals and SMEs, that operate in the Chinese market and have extensive history operating in China. All of the interviewees have either lived in China or have been highly involved in the firm's business in China. All still continue visiting and doing business in China regularly, making them well experienced with the Chinese market. The cleantech industry was chosen as the empirical focal point for this study as very little academic research has been conducted on this particular industry and because it is at the moment very relevant in the Finnish-Chinese trade and in the development of China as well as the whole world. The data collected from the interviews was analyzed together with the theoretical framework in order to analyze how well the theory was supported in practice and to understand the main differences and similarities. This study was executed as a qualitative research and the data was collected through five face-to-face semi-structured interviews to better understand the reasons behind certain opinions and phenomena's.

Through the interviews, this research identified several factors that impact the performance foreign firms operating in the Chinese market either negatively or positively and

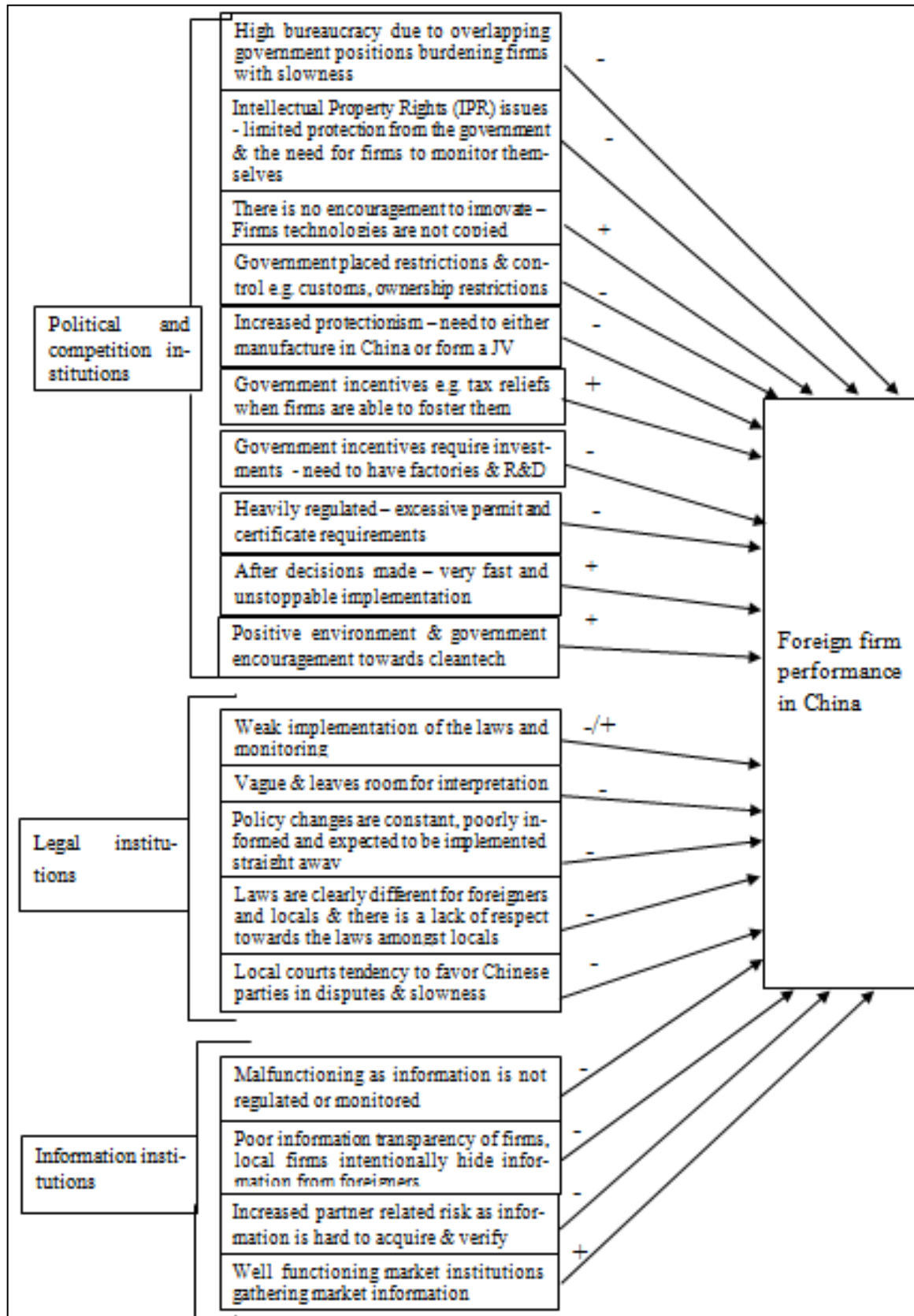


was able to find similarities with the existing literature but also new points of view. In the interviews, it came apparent that the managers clearly had found China's formal institutional environment to have more negative aspects than what came apparent in the theory. The findings of the formal institutions are summarized in Figure 7. In the formal institutions almost all of the factors and impacts found in the literature were supported by the interviews. The interviews also provided new information on the institutional environment that did not come apparent during the literature review. In the political and competition institutions the interviewees did feel that the bureaucracy is high in the government and government organizations and you need to be prepared to spend a lot of time meeting different people in regards of the same issues. In regards of IPR, firms did feel that it is an issue in the Chinese market and that the Chinese have a clear tendency to copy, but all in all the interviewees felt that this was just a regular risk of doing business in the market and mainly the negative effects come from the increased need to monitor the market, not from the copying itself. Even as the Chinese are skilled in copying, all of the firms found that the copiers have not been able to copy the core technology of their products, just the outside. For that reason IPR was not seen as such an issue as nothing vital had never been copied or spread in the market. But still the threat of IPR violations forces strategic constraints on firms, as they have to carefully evaluate what information they can give to China and what needs to be manufactured or produced home so that vital information is not spread to the market.

All of the firms had faced government set restrictions in the market and the ones who have manufacturing had faced even more restrictions. The main issues were restrictions on ownership that were extremely prominent in the industries that are strategically important to China. Other big restrictions and trade barriers were high customs payments when shipping inside of China. They were reported as being so high that in some cases it is more cost efficient to manufacture in Finland and do the shipments from there. The government was found to be very involved in the process of establishing a factory in China. Firms also found that the protectionism in the Chinese market is constantly increasing. This means that the government and government organizations are requiring more and more products to be manufactured and developed in China. This forces foreign companies to invest more heavily in the Chinese market and build factories and bring R&D if they wish to compete there. The other option is to formulate joint ventures with local partners. The interviewees were clearly concerned about how far this protectionism will go and there was even a fear that the Chinese market might someday close completely from foreigners.

Two out of the four firms had been able to benefit from government incentives and had found them very positive and encouraged to try and harvest them if possible. But on the other hand in order to get these incentives firms must invest heavily in China and often build factories and bring in R&D. Bringing in R&D then increases the potential of IPR violations. So the government incentives clearly have a negative side that firms need to carefully evaluate. Also the opinions concerning the level of regulations varied. The interviewees felt that the business environment is similarly regulated compared to the Western countries when it comes to the day-to-day business but when establishing a factory for instance the environment had been found very heavily regulated. Still it was noted that as you are able to reach the decisions and get the permits things start moving extremely fast and then there is nothing stopping it. Another positive factor in the political institutions, regarding especially the cleantech industry, was that the environment is increasingly more welcoming and encouraging towards cleantech as the government has realized the importance of cleantech for China's development and is trying hard to promote more cleaner solutions to better the lives of people.

In the legal institutions the issues of weakness in implementation of the laws, their vagueness and in the constant changes had been noted by all firms. It was said that there is often uncertainty on how new laws should be implemented and interpreted. This creates an uncertain environment for firms to operate in, as no one is really able to trust the law. Unlike in theory, this was regarded also as being a good thing in some cases as due to the issues in the implementation and the vagueness of the law firms have managed to bypass costly new requirements set by a regulation. Constant changes are eminent in the Chinese legal environment and were regarded as a big issue as laws can change in a day and these changes are often poorly informed so the foreign firms have challenges in trying to keep up with the changes and apply them accordingly. It was thought that the laws are often different for foreigners and locals, often so that they are much stricter for foreigners. Another issue is that the interviewees felt that even if the laws would be the same, the local players are more ignorant towards the law and often seem to bend it for their benefit. Furthermore, the interviewees felt that also local courts have a tendency to favor local players in addition to being extremely slow in their processes that firms often opt to not to use them in their disputes but prefer handle things on their own and hope to solve things through discussions with the violators.



**Figure 7.** The impacts of the formal institutions gathered from the interviews

The issues in the information institutions differed from the ones found through theory. It came apparent that in the market there are many well functioning market institutions that gather trustworthy information regarding the market itself so market information is easy to access. What was difficult to gain from the market was information regarding individual firms. According to the experiences of the interviewees, Chinese firms have a tendency to hide information and exaggerate it in order to seem like a more potential business partner. Firms really have to be careful or end up being deceived. Information needs to be verified and this is often a very long and resource consuming process. Firms have even had to make a specific requirement to help their staff to evaluate the trustworthiness of potential business partners and often this requires extensive meetings and visits to the sites to gain a complete picture. So information concerning local businesses is very hard to find and this affects the partner opportunities.

When looking at Figure 7 it is evident that many of the factors found in the literature review (see Figure 5) and their impact on foreign firms operating in China are also found in real life. In the interviews however, more positive factors and impacts were found than in the literature review such as the fast implementation of decisions, well functioning market institutions gathering market information and the lack of encouragement to innovate so no vital technology is copied. This study also found that there is a positive political environment towards cleantech as an industry. This of course is a very industry specific finding. Furthermore the interviews revealed that in some cases the weak implementation can be viewed as having a positive impact but this again is a very firm, industry and situation specific finding.

When it came to the informal institutions it was apparent that they are highly used as substitutes of formal institutions and also as a way to mitigate the complex formal environment. The findings regarding the informal institutions are presented in Figure 8. In the informal institutional environment the study found that the differences in culture depicted by the literature review were not as evident as one would have thought. When considering Finland and China on Hofstede's dimensions it seemed that there is a very high difference in the cultures. All of the interviewees did agree that the culture in China is highly different but noted that it is more visible in the daily life and in personal encounters. It was said that in the business environment, the cultural differences were not as visible as the culture and the way of doing business is relatively similar. The biggest differences in culture that were thought to affect the business dealings as well as the day to day operations of each firm and their Chinese offices and factories were the differences regarding hierarchy in a business environment, the differences in the com-

munication style as well as language barriers and also what was called a “code of silence” amongst the Chinese. In China, the business environment is very hierarchical, all of the final decisions are made by the managers in high positions and it was said that the interviewees felt that the Chinese employees always seem to wait for orders and lack the ability to go at things on their own accord. In the negotiations processes it was difficult to get any answers from the counterparty until you manage to meet with the “big boss” as no one wants to give answers that could be contradictory to what the final say from the big boss is.

This was linked with a code of silence as Mr. Rajamäki referred to it. The interviewees felt that it is very difficult to get anything negative out of the Chinese. If something bad has happened, a mistake has been made, no one would speak of it and you would really have to dig deep to try and find the answer. Also no negative feedback was given concerning the management, the tasks or the workplace even if the workers thought there could be room for improvement. This code of not saying negative things reflects on the information institutions and the tendency to hide negative information so that on the outside the firm seems better. The style of communication caused issues in the negotiation process. Whereas Finnish people are very systematic and goal orientated, the Chinese seemed to the interviewees to be very unsystematic in their discussions, going from one thing to another randomly and even when you thought something it had been decided things could change overnight and more discussions would be needed. This clearly shows that there are differences in cultures and that even as the interviewees did not feel that the differences are big, there are situations where the differences in Finnish and Chinese cultures clash. Language was another thing causing issues for foreign firms. English is still a minority language in the Chinese business environment so firms are forced to do business by using their local employees as mediators and translators

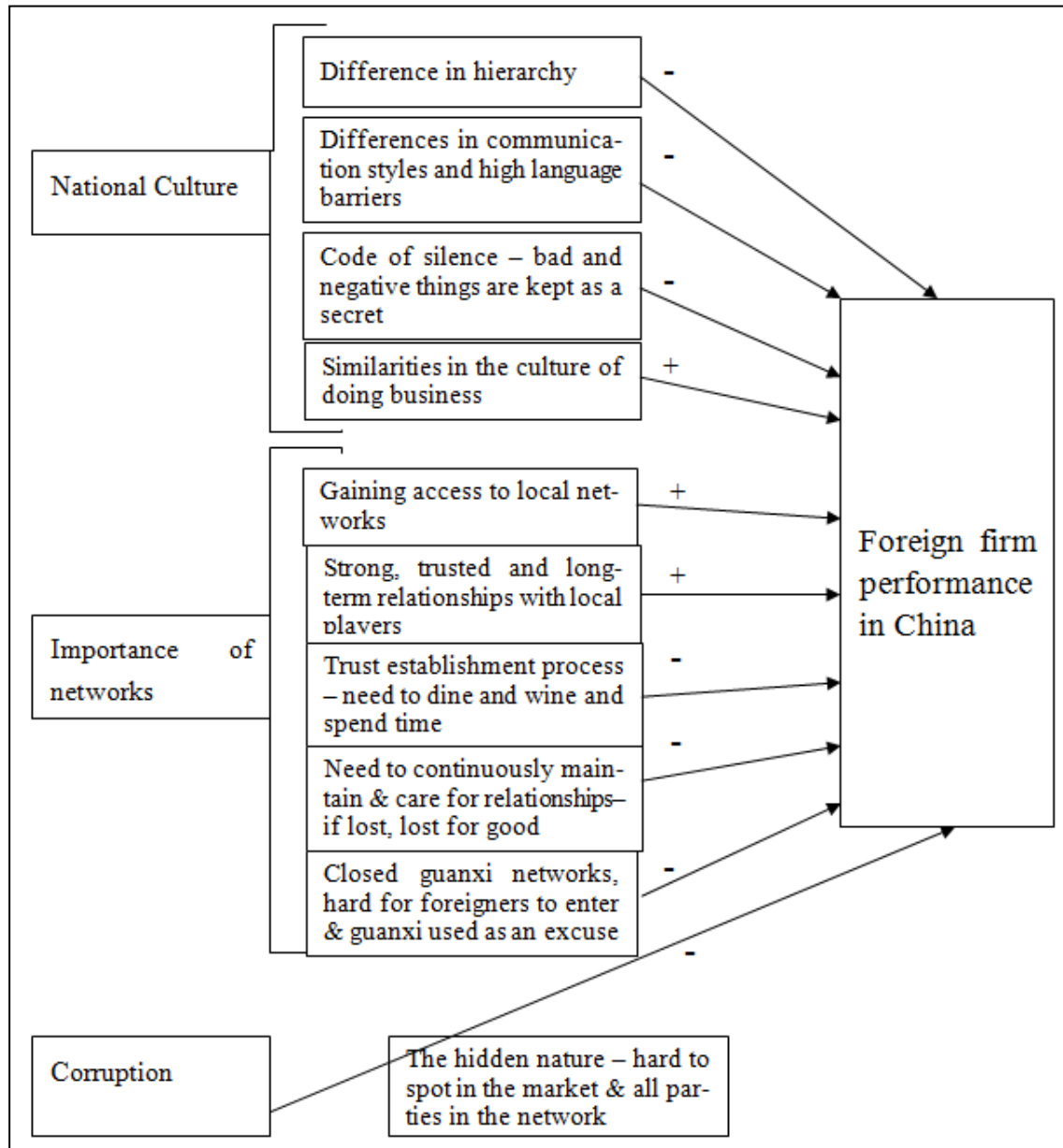
Already during the discussion on formal institutions it came apparent that in China, relationships are the most crucial thing to have in the business environment. Without good relationships and connections you cannot succeed in the market. These relationships help to navigate through the malfunctions present in the formal institutions such as the lack of quality information regarding local firms, the regulations and laws set and the possible government restrictions if you have good relationships with different parties in the market. Of course the building of these relationships and networks in the Chinese market is expensive. Chinese people value trust in a relationship over all other things and before the trust is created, no business transactions will happen. The building of this trust requires a lot of time and money spent, dinners and evening sitting together and

getting to know the other party on a relatively personal level. Also the trust is constantly measured throughout the relationship and you must be willing to continuously invest in it, show that you keep your promises and deliver what is agreed upon, provide service and wine and dine in several occasions. This is vastly different from the way business is done in Finland. There are occasions when there is dining and wining involved but mainly business is handled through very impersonal transactions such as phone or email.

So it is important that firms understand the importance of relationships and their formulation in the Chinese market and are willing to continuously invest in the relationships. Because if the relationship or trust is lost, it is gone possibly forever. The Chinese market has another distinct feature when it comes to relationships. In the market, there are what in Chinese is known as *guanxi* and *guanxi* networks. *Guanxi* itself is often understood as a network of favors between different parties. In theory it was regarded that entering into a *guanxi* network is highly beneficial for firms but in the interviews it came apparent that these networks are very difficult, almost impossible to enter into. It often comes down to the fact that the foreigners do not really understand what *guanxi* really is, so it is hard for them to join the groups but also because often they are closed for foreigners. *Guanxi* is highly used in the dealings between locals and it was sometimes found that the sales people use *guanxi* as an excuse for not getting a deal.

Corruption is another issue in regards of the informal institutions. In China, corruption is very embedded into the everyday life of people. Extra payments are given even to primary school teachers just to make sure that your child is put at the front of the class so they can learn. For western people, corruption is very strongly judged and firms coming from western countries have strong guidelines and rules how to avoid and deal with the threat of corruption. Even with the codes of conduct, corruption is very hidden in the marketplace and it is very difficult for foreigners to actually understand what its corruption and how it shows in the market. It was said that the Chinese intentionally try and hide corruption from the western managers as they know that they would take action against it. Many of the interviewees replied that even as they educate their suppliers and subcontractors about corruption and demand them to follow the same guidelines as they do, there still is no guarantee that someone down the line is connected with corruption. It was also viewed that mainly corruption happens in the dealings between locals. But it was emphasized that none of the firms interviewed had anything to do with corruption and that they cannot participate in it as it would mean the end business both globally and in China. The Chinese government is taking increasing action to eradicate to bring

the corruption level of the country down but China still ranks very high on the indexes measuring corruption. Where as in China corruption was said to be a natural part of everyday life, for a foreign firm it can be devastating if a link with corruption is made.



**Figure 8.** The impacts of the informal institutions gathered from the interviews

## 7.2. Conclusions and managerial implications

The purpose of this research was to elaborate the importance of institutions in the business environment, especially in the context of the emerging markets. This was done through an extensive literature review after which a framework was established that depicted factors that both positively and negatively impact foreign firms operating in China. This framework was then tested through interviews and as the interviews were evaluated together with the theoretical framework it showed multiple similarities with the framework and also some differences as well as new factors. It is obvious from this research that institutions have a great impact on business and firm performance. Both the formal and informal institutions play a vital role in the formulation of firm strategies and the performance. This research on the institutional environment of the emerging markets focused on both the negative impacts the turbulent environment has on firms, especially when considering the formal institutions, and also the positive impacts the development of the institutional environment has on foreign firms operating and wishing to enter into China. In both the formal and informal institutional environment, this study found factors that impact a foreign firm both positively and negatively. The main areas for negative impacts were government restrictions, increasing protectionism, IPR issues, heavily regulated and bureaucratic business environment, weak implementation and governing of the law as well as constant changes in the legal institutions, the tendency to favor local players in the market, poor information transparency regarding local firms, corruption, some cultural differences affecting mainly the negotiation process and the costs of establishing and maintaining relationships. Even as the list of negative factors in the market seem overwhelming, there were also positive factors in the market such as government incentives, lack of encouragement to innovate in the market so critical technology is not copied, weak implementation of the law that lets firms bypass costly new regulations, extremely fast implementation once decisions are reached, similarities in the business culture, well functioning market institutions gathering market information and strong, long lasting relationships that help bypass many of the negative impacts created by the weaknesses in the formal institutions.

The model created in this study tries to integrate both formal and informal institutions to investigate how they both simultaneously impact on the performance of a foreign firm operating in the emerging market of China. It is important to view the institutional environment as a whole to better understand the relationships between different institutional factors. It came apparent in the study that the informal institutions are heavily relied on to substitute the lack of formal institutions. Therefore, as the formal and informal insti-



tutions are clearly linked and connected, they should be studied more together to then better evaluate their full impact on foreign firms. Often studies have a tendency to focus on a single aspect of the institutional environment. It is important to study both formal and informal institutions as a whole to better understand their interrelatedness and not try and see them as two separate sides of the institutional environment. Some might argue that as the institutional environment of the emerging markets continues to develop, the need for informal institutions and relationships diminishes and therefore the focus should be on the developing formal institutions and their transition. Still in the context of a collectivistic culture such as China, with a long historic tradition of relying on the informal institutions in their business dealings, the informal institutions will most likely continue to be of great importance in the market even after the formal institutions have developed.

It came apparent during this study that the previous theories have regarded many of the aspects in the institutional environment in a very black-and-white manner meaning that different institutional aspects have been viewed to have only a negative or a positive impact. In the interviews it came apparent that you cannot view the business environment one-dimensionally as many of the institutions have both negative and positive impacts, depending on which way you are looking at them. Whereas the weak implementation of the law is generally seen as a negative factor hindering firm performance and actions in a market, it came apparent that in some cases it can be seen as a positive. When firms are confronted with new regulations that impose extra payments on them but as the law is never implemented or is implemented only partially, firms are able to skip these extra payments thus saving possibly very considerable amounts of money.

It is important to note that, even as many of the impacts of the institutional environment are seen as having a negative impact on foreign firms operating in China, the huge market size and the markets growth potentials outweigh these negatives for firms. All of the firms interviewed for this study emphasized heavily that China is either their most important market or it is amongst the top three most important markets for the company and has growth potential beyond all other markets. Even with all of the issues with IPRs and the high threat of corruption, a firm might not have an opportunity to grow or the growth does not reach the full potential unless they enter into the Chinese market. It was also noted that China has very big potential to grow and continue to develop its institutional environment. The changes that have happened in China have been tremendous but the country still has a long way in the development of its institutional environment so that it becomes more stable and reliable for foreign firms to do business in. The in-

interviews showed that China has many issues that harm its development. There is a lack of political continuity, a lack of coordinated activities between the central and local governments, the growing differences in earnings between different social groups and the increasing issues with the environment. Institutions governing China have a huge impact on all of these aspects and as said in the interviews, one of the main issues that needs to change in China is the culture so that the development that is needed can happen.

This study provides a few useful guidelines for manager. Firstly, it provides a comprehensive understanding of institutions and the institutional environment of the emerging markets, especially the emerging market of China. This study can help managers understand the importance of institutions when entering into a new host country market. The main point of this thesis is not to discourage firms from entering and operating in China. It is to evaluate what the current situation is in the institutional environment and how do firms feel that it affects their operations there and give recommendations for firms thinking of entering into China. The main point is to draw the attention of managers to the institutional environment as a whole, not just consider a single aspect in the market as it is often done in previous studies. Managers should carefully aim to take into account the institutional environment in which they function and try to anticipate and adapt to the changes happening. This way a firm has the ability to take advantage of the new opportunities presented by the economy. Firms need to carefully analyze the development in the formal institutions and informal norms as well as taking into consideration the firms' own resources and the industry development.

As the Asian economies and especially China continue to implement reforms on their institutions the institutional environment of this country will increasingly become similar to the institutional environment of the developed countries. This means that the differences in the markets will continue to shrink and more characteristics from the developed countries will be implemented. This is important to bear in mind as in the world there are markets that are just starting to emerge so by learning from the institutional development currently happening in China managers can learn and be more prepared when starting operation in these newly emerging countries in Asia and Africa.

Firms are clearly spending a lot of resources in trying to understand and foresee the subtle hints that Chinas institutional environment gives. This is evident in all of the firms' behavior in the Chinese market. For the Switch, it resulted in a costly investment to a factory in the beginning when they predicted there to be a demand to have all products

sold in the Chinese market made in China and they have now managed to turn this guess profitable. For Wärtsilä, this is visible in their strategic decision to participate in joint ventures in case the protectionism in the Chinese market increases. This shows that the Chinese market and the institutional environment is constantly developing and it forces firms to be on their toes to try and guess the direction and react to it in advance. It is important to understand the institutional environment of the target country and the impacts that different institutional factors have as they affect the strategy of a firm and also allows managers to anticipate the changes that can happen in the market.

### 7.3. Limitations

This research has a few limitations. First of all, the empirical part of this research is based on the interviewee's subjective opinions and perceptions and reflect their personal experiences. Secondly, the sample size was small due to the qualitative nature of the study as well as due to the limitations of time and resources. Thirdly, this study focused only on interviewees from one home country, Finland, and only from one industry as well as operations in only one host country. Furthermore, the interviewees had all worked in different positions and for different amounts of time in or with the Chinese market so their experiences varied. For all of these reasons, generalization of the findings and the interpretation of the results must be made with caution. However, the aim of this research was to better understand the topic rather than make statistical generalizations.

Due to the limitations of time, this study was not able to include all of the aspects and factors found by previous studies in the institutional environment of China. Therefore the results do not depict a complete picture of the institutional environment. This study uses firms only from one home country, Finland, a small open economy, meaning that the results are not suitable for a very different context. However, this study still provides interesting insight into the relatively unexplored research area of how the institutional environment of the emerging markets is perceived by firms from the Nordic region. As this study interviewed only Finnish managers, the understanding of the Chinese environment was based only on their own time spent in China and doing business with China. Therefore, as no local personnel or managers were interviewed, some crucial information regarding the Chinese cultural context and heritage might not have come across in this study. In regards of factors such as *guanxi* and corruption, that were said to exist mostly in local-to-local business, this study might have not been able to

fully understand the phenomenon and an interview with a local might have been needed. Also as all of the firms interviewed are located in the coastal area of China, the possible differences in the institutional environment between different regions in China could not be studied and thus it was left unclear if there are great institutional differences and how should firms prepare for them. Therefore this study only provided the suggestions regarding one region in China that is often viewed as being one of the most welcoming areas for foreign investment. On the other hand, this study provided the viewpoint of a foreign firm unfamiliar with the Chinese institutional environment, therefore providing insight into areas that might not be relevant to local people and businesses. This study also focused on the relatively unexplored industry of Cleantech, thus providing an insight into what is happening in this new, up and coming, sector.

#### 7.4. Areas for future research

The limitations mentioned in the previous section offer many opportunities for future studies. For future research, it is suggested to expand the sample size to include other industries and also companies from other Nordic countries to better study the institutional pressures set on a firm operating in the emerging economy of China. In order to gain a deeper insight into the Chinese institutional environment, local managers could be interviewed together with foreign managers to gain a deeper understanding of the culturally bound issues and on how the differences between cultures affects the ability to assess the institutional environment. Furthermore, firms located in other regions in China could be interviewed so that an understanding of the possible differences of the institutional environments between regions could be better evaluated and recommendations for firms could be made for China as a whole. Also the viewpoint could be expanded to include more aspects of the institutional environment in order to create a more comprehensive picture. Another area for further study is to expand the viewpoint to include other emerging markets. Many other emerging markets are in the process of transforming their institutional environment and are increasingly attracting more foreign investors and companies. Therefore these markets could be included as well and a comparison between different emerging markets could be attempted. Especially in the cleantech market emerging markets are in clear need for more environmentally friendly solutions. As cleantech as an industry is still relatively unexplored, it is recommended that future studies continue to investigate this industry as it grows to gain more insight into the industry itself and also to the different factors critical to this industry.

As China continues to develop its institutional environment, more studies are needed in the future so that the development and the underlying causes behind this development can fully be understood. China faces challenges and a need to try and change its culture so another study focusing on the institutional environment of China could be executed in the next 10-20 years to then assess the development or the lack of development in the Chinese institutional environment.

In this study it became clear that some of the answers are very industry and firm related. In order to gain a better understanding of all the different factors in the Chinese market that impact foreign firms, the market should be considered through all three legs of the strategy-tripod: industry based competition, firm specific resources and capabilities and institutional conditions and transitions (Peng 2009: 15). Even as in the emerging market context the institution based view is argued to be the most suitable, to gain a better understanding of the different factors that impact firms operating in the emerging market, firm and industry factors could be included in future studies.

In the Asian market, India has been another attraction for Finnish firms. Finnish firms have been increasingly investing in India for the past decade or so. In the initial stages of this study it was thought that it could have been conducted as a comparison study between the Chinese and the Indian market but due to the time constraints and the limited availability to managers having been to India it was decided that this current study focuses solely on China. Even as India is seen as a big market the case companies interviewed only had very limited operations in India. Vaisala has only a small, one man operated sales office and the company feels that the Indian market currently is not growing in the way it was expected and the institutional development seems to have somewhat seized so the country provides only limited opportunities. The Switch also did not see India as a potential market for growth. Vacon and Wärtsilä have more extensive operations in India and see a potential in the market but the availability of interviewees was very limited as only one or two Finnish managers from each company had ever been to India and these expatriations had happened several years ago, so current information was hard to find. As the institutional environment of India is relatively unexplored and has been remarked to have issues in its development and as the market seems to be of interest for foreign firms it could be a potential area for future research to investigate the institutional environment of India and also aim to for a comparison together with other emerging markets such as China.

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## APPENDIX 1

Category	Score	Global Rank	Regional Rank
IPR Index	5.5	57 of 130	8 of 18
Legal and Political Environment	4.3	76 of 130	13 of 18
Juridical Independence	5.5	59 of 130	12 of 18
Rule of Law	4.1	81 of 130	12 of 18
Political Stability	3.6	94 of 130	11 of 18
Control of Corruption	3.8	91 of 130	12 of 18
Physical Property Rights	6.8	35 of 130	8 of 18
Protection of Physical	6.9	44 of 130	9 of 18
Registering Property	9.0	29 of 130	6 of 18
IPR	5.4	59 of 130	10 of 18
Protection of IPR	8.2	33 of 130	5 of 18
Patent protection	8.2	33 of 130	5 of 18
Copyright Protection	2.3	79 of 130	24 of 18

Region profile of China (Intellectual property right index 2013)

## APPENDIX 2

Corruption Perceptions Index 2013: Asia Pacific		
Rank	Country	Score
1	New Zealand	91
5	Singapore	86
9	Australia	81
15	Hong Kong	75
18	Japan	74
31	Bhutan	63
36	Taiwan	61
38	Brunei	60
46	South Korea	55
53	Malaysia	50
80	China	40
83	Mongolia	38
91	Sri Lanka	37
94	India	36
94	Philippines	36
102	Thailand	35
114	Indonesia	32
116	Nepal	31
116	Vietnam	31
119	Timor-Leste	30
127	Pakistan	28
136	Bangladesh	27
140	Laos	26
144	Papua New Guinea	25
157	Myanmar	21
160	Cambodia	20
175	Afghanistan	8
175	Korea (North)	8

## APPENDIX 3

### Interviewee Name and Title, Date

1. Is it ok if this interview is recorded?
2. Can Your name be used in the thesis or do you wish to remain anonymous?

### Part A, background

1. If you could first tell a bit about yourself and your experiences of China and operations there.
2. What are the reasons behind going to China? When did your company go there and what is the level of operations now?
3. What does China mean to your company?
4. If you know and are able to discuss, what are the company's future plans there?

### Part B. The impacts of the institutions

#### Formal

1. If you compare for example the Finnish and the Chinese market, what are the biggest differences in the market that come to mind?
  - a. If you compare the Chinese market as a whole, would you say there are vast regional differences when operating in different parts of China?
2. How do you perceive China's political atmosphere right now? Do you feel that there is something that specifically is aimed at cleantech firms?
  - a. How do you feel that the political environment of China has changed over the past years? Can you see any major differences?
3. In your opinion, do you feel that the Chinese government has placed some types of restrictions or objectives on your operations in China or overall on foreign firms?
  - a. Do you feel that the government has in any way tried to influence your operations there?
  - b. If yes then how has this been visible?
  - c. If no, then why do you feel it is so?
  - d. Are there any government set targets or requirements on your actions?
  - e. How do you feel that all of this has affected your performance and the way you do business in China?
4. Has your company perhaps gained some type of support or incentives from the Chinese government?
  - a. If yes, what has this support been like/what type of support?
  - b. Have there been any requirements attached to these incentives? And how has it affected your actions and performance?

5. If you evaluate the situation from the viewpoint of a foreigner, how regulated do you feel that the Chinese business environment is?
  - a. If you compare to Finland for example...
  - b. Do you feel that the market is highly regulated? How is this apparent in the market? For example are multiple permits required or how...?
  - c. What do you feel is the impact on your performance?
6. Do you feel that the Chinese market is bureaucratic?
  - a. If yes, then why would you say so?
  - b. How is the bureaucracy apparent in the Chinese market?
  - c. And how does this affect your actions and performance?
  - d. Do you feel that the bureaucracy has increased or decreased over the past few years?
7. How do you see the Chinese legal environment?
  - a. Do you feel that you can rely on the law? If not then why do you feel so? Examples...
  - b. Again, how does this then affect your performance?
  - c. How do you feel that the implementation of the law is? Are the laws very straight forward and easy to interpret and follow?
  - d. Overall how do you see the development of the Chinese legal environment? What kind of development has there been?
8. Changes in the laws, are there changes in the Chinese market?
  - a. Does it happen often?
9. If laws change, how are these changes informed? Do you feel that you can easily get the notifications and the information?
  - a. If no, how do you get the information?
10. What is your view on the Chinese court of law? Do you use the in disputes? If no, then why not?
11. What comes to your mind when you think of IPR and China?
  - a. Are there any issues or problems regarding IPR?
  - b. What do you feel these issues are and how do they affect your performance?
  - c. How do you protect your IPR in China? What kind of actions have you taken? How do you monitor the use of your IPR?
  - d. If a violation by any chance should happen, what kind of actions can you take? Or which are the best actions to take?
12. Do you feel that information is easily and freely accessible in the market?
  - a. If not, what kind of information is hard to find?
  - b. What do you think causes this?
  - c. Where can you get the information you need?
  - d. What kind of situations has this unavailability of information led?

### Informal institutions

1. Do you feel that China and Finland are culturally different?
  - a. If yes, what are the biggest differences? And what are the similarities?
  - b. How do you feel these cultural differences affect and what are the things they have an impact on?
  
2. What kind of meaning would you say relationships and networks have in the Chinese business world and when doing business in China?
  - a. How would you feel this emphasis on relationships is reflected when doing business in China?
  - b. What types of relationships are needed? And what can you gain from these relationships? Good or bad
  - c. How has your company established these relationships
  - d. Do you feel that relationships with the government are needed?
  - e. What are the main benefits of these different relationships? And how do they affect your performance?
  
3. Does the term Guanxi mean anything to you? How do you understand it? What is the meaning of it in the Chinese market and business?
  
4. Do you feel that there is corruption in the Chinese market?
  - a. Have you personally faced or seen corruption? In what ways does it show in the market? Or is it completely invisible for foreigner?
  - b. How does your company protect itself from corruption?
  - c. How has corruption or the knowledge that corruption exists in the market affected your actions in the market?

### In the end

- Just as a recap, if you could please tell me what are the factors in the Chinese that have helped you to succeed in the market & what are the factors that might have hindered your success?